UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK
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SECURITIES AND EXCHANGE COMMISSION,

Plaintiff,

v. 13 Civ. 1735 (GBD)

CARRILLO HUETTEL LLP, et al.,

Defendants.

Argument

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New York, N.Y.
March 19, 2014
10:41 a.m.

Before:

HON. GEORGE B. DANIELS

District Judge

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(In open court)

THE DEPUTY CLERK: This is the continuation of the oral argument in Securities and Exchange Commission versus Carillo Huettel, LLP, et al. and also that is 13 CV 1735.

THE COURT: I'm not going to need everybody's appearance again. I think the court reporter has it all.

I think where we were the last time, there were two more defendants who had to be heard from. Who was that?

MR. FELDMAN: Your Honor, it's Steven Feldman on behalf of Benjamin Kirk. We did not have a chance to speak last week.

MR. SALLAH: Likewise, your Honor, he's going to go first. But James Salah on behalf of Mr. Hinton.

THE COURT: All right.

MR. FELDMAN: Good morning, your Honor.

THE COURT: Good morning.

MR. FELDMAN: Thank you for taking the time to accommodate us again. We represent Benjamin Kirk, one of the Kirk brothers.

I know last time we were here, reality playing out, part of the problem we were trying to raise in our motion is we talked over and over again about Kirk, Kirks. We never distinguished between them. There's actually two Kirk brothers in the case. There's John Kirk and there's Benjamin Kirk.

The complaint alleges that John Kirk ran an operation

called the Emerging Stock Report in Vancouver, in Surrey, and that Benjamin Kirk ran an operation called Skymark ten hours away in Calgary. And apparently they all ran them together, because the allegations are that they operated, set up and jointly ran everything as one big group. As a practical matter, I don't see how that works.

We have three main points we raised in our argument, in our papers, I want to address with you today. One is that as to the 10(b) and 17(a) fraud allegations, the complaint doesn't meet the 9(b) requirement. As to Benjamin Kirk in particular, the complaint doesn't detail what he did wrong, doesn't explain his particular conduct, doesn't say what Benjamin Kirk is responsible for. So it doesn't put him on any notice so that we can focus and defend him in this case. It's not rocket science to make allegations that somebody ran a boiler room, that they made phone calls, that they lied to people on the phone. But that's what's missing in this complaint.

Second, we argue that as to control person liability, under Rule 20(a) the SEC alleges Mr. Kirk operated, controlled, was the ultimate authority over this Skymark operation. That's what they say. But when you look at the complaint and take the time to actually study what they say, there are no facts in there showing that Mr. Kirk directed, managed, operated, was the guy responsible for Skymark. So, again, we're missing the

allegations. And under your Honor's decisions in a number of cases, your Honor has pointed out that the parties need to provide specific facts as to somebody's role as the ultimate operator.

And third, we want to make an argument to your Honor that process here is insufficient as to Mr. Kirk; that the SEC represented to your Honor that it had reasonably attempted to serve Mr. Kirk in Canada in order to get an order to do alternative service. In fact, they hadn't reasonably attempted to serve him in Canada at all, and yet they made that representation to your Honor and got this alternative service motion. And because we think your Honor was given inaccurate information about these reasonable attempts, that service was not proper.

THE COURT: Well, let's address that first so we can put that aside and we'll deal with the more substantive issues.

What do you say they should have done?

MR. FELDMAN: Well, what they said to your Honor was we made reasonable attempts. And when you study what they did, they also said "we think Mr. Kirk fled Canada." So they went to apparently an address that they say was the last known address in Canada, and they kept trying to serve him there, which to me is the exact opposite of reasonable. If you know somebody doesn't live --

THE COURT: I assume if they didn't do that, you'd be

complaining they didn't even bother to do that.

MR. FELDMAN: I would say at a minimum, they're an investigative agency. They were conducting an investigation. You try to figure out where the guy is and you try to serve him where he is.

THE COURT: So I'm not quite sure what you claim the circumstances were.

MR. FELDMAN: I claim --

THE COURT: They say they couldn't find the guy. They looked for him. He's making himself scarce. Judge, would you allow us to do substituted service, because we know he'd get notice, but he just is making himself not available for service? What else --

MR. FELDMAN: My issue, your Honor --

THE COURT: -- should they have done or said?

MR. FELDMAN: My issue is the representation they made to you that they attempted reasonable service when they went to a house they believed he didn't live. They repeatedly tried to serve him there, but they told you what's reasonable to serve him --

THE COURT: That's a legal conclusion. That's not a misrepresentation. The misrepresentation would be to tell me that they did X and they really didn't do X.

So what is it that you say they did in support of their application to get substituted service, that they did

that they claim was a reasonable attempt to serve him that you say was a misrepresentation to the Court?

MR. FELDMAN: They went to a place where they believed he didn't live. They attempted to serve him there over --

THE COURT: But what misrepresentation did they make with regard to that attempt?

MR. FELDMAN: Then they told your Honor that they had reasonably attempted to serve him --

THE COURT: I know, but that's not a misrepresentation. That's not even a fact. That's a legal conclusion.

MR. FELDMAN: That was an allegation --

THE COURT: That's a legal conclusion. What is it --

MR. FELDMAN: That was a representation they made to you in order to get --

THE COURT: But that's not the representation I relied upon. The representation I relied upon is what, in fact, did you do to reasonably serve him? And what way can I conclude that you've made reasonable attempts to locate him and serve him?

So I made my decision of substituted service based on what they told me they did and what the possibilities were that they might do something else that would serve him. So what is it that you're saying that they -- you're not saying that they misrepresented any act that they took in terms of service?

MR. FELDMAN: I'm saying that in describing their acts it was not a fair description.

THE COURT: It was not a fair description because they called it reasonable?

MR. FELDMAN: Right.

THE COURT: And it wasn't reasonable?

MR. FELDMAN: And any reasonable person would know that serving somebody where you know they don't live is not the way to go about making service.

THE COURT: But what else -- I'm not sure what else you say --

MR. FELDMAN: What you do is you investigate, try to find out where the person lives, and then you try to serve them there. There's all kinds of tools out in the world where one investigates.

THE COURT: But I want to make sure I understand your legal argument. Is your legal argument that they should not have gotten the substituted service and then misled the Court by giving the Court improper facts; or is it just that, well, they said what they did was reasonable and it really wasn't reasonable, because they could have done some other thing?

MR. FELDMAN: I think my point is exact -- that they represented to you that what they had done was reasonable when it was not.

THE COURT: Okay.

MR. FELDMAN: That you considered that, and because we were not in the case, we didn't respond to the motion. So you considered that in making your decision.

THE COURT: No, I didn't consider that. I mean, if I made decisions based on what the lawyers told me were reasonable, I'd have a lot simpler job. I don't make decisions based on the lawyers' representation it's the reasonable thing to do. I make decisions based on the factual representations they make to me. And I made my conclusion about whether or not that was reasonable and there's something else they could have done.

I don't remember the details of it, but my recollection at this point is that I did make a further inquiry about whether they did some other things and whether or not some other attempts might be successful to locate him. So I'm not sure what it is that you say that if they had done X, that that would have been the reasonable thing to do and that would have located him. Are you making that argument?

MR. FELDMAN: I'm suggesting -- first of all, your Honor, as to your point that you asked them to do more, I don't know anything about that. Perhaps you did ask them and went back and scrutinized. My point is that --

THE COURT: I may be wrong, but I thought -- and they can correct me, too -- I thought that there was some discussion on the record of this before -- but maybe there wasn't.

MR. FELDMAN: I don't think there was any on the record here.

THE COURT: I don't remember, because I remember --

MR. FELDMAN: But my point is if when one scrutinizes their papers -- we didn't have the benefit of an adversarial scrutinizing because I didn't get involved. But when one scrutinizes the papers, you have a paper that says "we repeatedly served the place. We know he doesn't live there, but now we're representing we've met the reasonable effort standard and, therefore" --

THE COURT: So tell me what they could have done that would have located him.

MR. FELDMAN: You know all the things people can do.

THE COURT: No, I don't. I don't know where the guy was.

MR. FELDMAN: You search credit card records. You talk to law enforcement. You send out an investigator. You ask people in the neighborhood.

THE COURT: Slow down. I'm not asking you in the abstract. I'm asking you specifically. What should they have done that would have located your client, and where would it have located him so that they could have served him?

MR. FELDMAN: They should have gone to court in Alberta anytime he had a court appearance, because he shows up there every time. And they should have handed him the piece of

paper there. That's what they should have done.

THE COURT: So they knew that he was going to court?

MR. FELDMAN: They're cooperating with the Alberta securities commission. Absolutely. I'm sure they knew every time he had a court date and when he has to show up. That would have been service.

THE COURT: Okay. So what was unreasonable about going to his address several times in trying to locate him and trying to find a business address for him, which there was none, and trying to locate him by asking his attorneys and others, and nobody wants to provide them that information?

MR. FELDMAN: What was unreasonable, your Honor, is they've told you in their application that he was a fugitive a year or two earlier, right? So they said that he had left Canada. He had left Canada because he was a fugitive from justice. That's what they told you in their application. And then they went to an address in Canada and kept serving him there.

Now, to me, that's the definition of making a mockery of what a reasonable effort is.

THE COURT: I'm not sure that I could agree with that. The marshals do that all the time. You'd be surprised where people show up when they live someplace and they're fugitives, and they come right back to where they live for some reason. So that's not --

MR. FELDMAN: But clearly, your Honor, he wasn't a fugitive. He was showing up in Alberta in court every time he had an appearance.

THE COURT: Let me ask you this, then we can move forward from that. Again, I've just got too many facts in my head. I want to make sure I'm not mistaken.

My understanding was they specifically asked his lawyers where he could be served, and they refused to give them that information. I don't know if that was you or other lawyers, but am I incorrect in characterizing it that way?

MR. FELDMAN: No, they certainly inquired of the lawyers whether the lawyers would accept service.

THE COURT: I thought it was more than that. I thought they inquired of the lawyers where he could be served, if the lawyers were not accepting service. And the lawyers would not provide any information as to his location.

MR. FELDMAN: They may have asked the Canadian lawyer where -- I don't know the answer to that, your Honor. But to me, that's fine.

THE COURT: That's kind of important, right? If I say, look, the guy's not home. We know he's got -- you tell me that they know he's got legal proceedings. They call up the lawyer and say, "look, we're trying to serve your guy. You can't run forever. You know, if he's hiding out, if you won't accept service -- accept service. If you don't want to accept

service, tell us where he is and we'll give him the piece of paper and we'll move forward."

The lawyer says, "take a hike," you know.

And they come to the court and they say, "look, Judge we tried to serve the guy. He's not home. The lawyers don't want to tell us where he is. You know, we have no way of knowing whether this guy is in Timbuktu, Canada, China or anyplace. But we've gone to his last known address, we tried to locate him through the people we know are at least in communication with him. Nobody wants to give us his information. We know he will get notice. Can we do substituted service?"

If I'm not incorrect, that's pretty much the scenario that I had. Would that be accurate?

MR. FELDMAN: I think in part, except for the part where they said, "your Honor, we kept trying to serve him at his home" but they don't point out that they know he doesn't live there.

THE COURT: How do they know he doesn't live there?

MR. FELDMAN: They represented it in the same application that he had left Canada two years previously.

THE COURT: Yeah, but --

MR. FELDMAN: That's how they know he doesn't live there. They represented it to you.

THE COURT: He didn't sell the house.

MR. FELDMAN: I don't know if he ever owned the house. They didn't represent he owned it. It was an address he used two years ago, whatever --

THE COURT: Are you representing that at the time they served it, that was not a legitimate address for him?

MR. FELDMAN: I'm not representing anything about the details of where the house is.

THE COURT: You can't argue it's unreasonable if you can't represent that that wasn't his residence or that wasn't his address.

MR. FELDMAN: I don't think it's a factual question, your Honor.

THE COURT: No, it's a question of reasonableness.

MR. FELDMAN: It's a question of someone telling you "we know he doesn't live here, but we keep serving here and we think that's reasonable." To me, that's the definition of unreasonable --

THE COURT: Well, where else --

MR. FELDMAN: -- serving the same place you know somebody isn't. They could say, "your Honor, look, we don't know where he lives. We've done these investigative steps to try to find where he lives. We still couldn't find it. We've done these other steps and, therefore, we think we've made the right application."

THE COURT: Didn't they --

MR. FELDMAN: That's not what they said.

THE COURT: -- also attempt to serve him through the Hague?

MR. FELDMAN: No. The service through the Hague was the delivery to the house where they knew he didn't live. That was the Hague service.

THE COURT: Okay. So --

MR. FELDMAN: Anyway, that is the argument, your Honor.

THE COURT: And this is not an argument of lack of due process notice. This is technically an argument that because they couldn't find him, they knew he wasn't to be located at his last known address and the lawyers weren't going to give them any information to find him or accept service on his behalf, it was not a reasonable conclusion to reach that they -- it was an inappropriate conclusion to reach what they did what was reasonable to attempt to locate him.

And my final question, again, would be the same question I had before. And I'm not sure there is an answer to it. What is it that you say that they could have reasonably done that would have effectuated service?

MR. FELDMAN: We're asking -- we're using reasonable in ten different ways here. My point, my point is that they made a representation that they had reasonably attempted to effectuate service. They based that representation on the fact

this they repeatedly went to a house where they knew he didn't live.

THE COURT: Well, that's not --

MR. FELDMAN: That he --

THE COURT: That's not all they did. They also asked the lawyers --

MR. FELDMAN: Correct.

THE COURT: -- would they provide information so that he could be located. And they asked the lawyers, would the lawyers accept service on his behalf? And they said no to both those questions. So that is also further attempt to attempt service. It's not just, we just went to his last known address.

And you say you want me to make a conclusion that that was not reasonable, but you still don't represent to me in what way it was unreasonable to attempt to serve him at this address.

MR. FELDMAN: I represent to you that it's unreasonable to serve a person at an address where you believe they don't live.

THE COURT: No, it's unreasonable to serve a person at an address that he, in fact, doesn't live. Are you saying that he didn't live there, that that was not his residence; or is that --

MR. FELDMAN: Your Honor, I don't know the details of

where he lived on any particular day --

THE COURT: But they don't either.

MR. FELDMAN: -- and the date they showed up. But they represented to you that he had left Canada two years previously. So do an investigation. Find out where he lives and serve him there.

THE COURT: What investigation could they have done that would have located him in some other country? What would be reasonable? Reasonable means they would have likely been successful.

MR. FELDMAN: Any steps in an investigation, anything, any minimal effort to investigate, I think, is what's required.

THE COURT: Give me an example of the minimal effort. They did the minimal effort.

MR. FELDMAN: They did no investigation. They called his lawyer, right? I mean, that's the minimal. I think the minimal is doing some investigation, trying to locate the person. There's all kinds of tools we use trying to locate people.

THE COURT: I think what is -- then we can move past this. I think what is the tough issue for me to hear is that given the fact that he had ongoing litigation and the fact that he was represented in that ongoing litigation, and the fact that the lawyers were not willing to make him available for service or provide any information so that he can be served,

the only logical conclusion is that he preferred not to be served, okay? So it's kind of -- that argument would be a little bit better piecemeal.

But once you say -- you can't say to me, why don't they just hang out at the courthouse, see when he shows up. They went to the lawyers and said, "look, we don't want to have to bother to hang out at the courthouse every day. We're asking you, where's the guy you want to take the paper?"

MR. FELDMAN: But why can't you find a court date and show up and serve people? We all do that all the time. If you know that somebody has to be in court at a certain day, you serve them there.

THE COURT: You can, but it's tough --

MR. FELDMAN: That's not rocket science.

THE COURT: That's true. But it's tough for me to say that's the only reasonable course of action after you've gone directly to the lawyers who represent him in that court proceeding, asked them where is he and they say "we're not going to tell you."

MR. FELDMAN: It would have been a more reasonable course than going to a house you don't think he lives at and then representing to the court that you made reasonable effort.

THE COURT: All right. Now, if, in fact, they had reason to believe that he would not return to that location --

MR. FELDMAN: Right. They represented that he had

left Canada years earlier. That's what they represent.

THE COURT: All right.

MR. FELDMAN: But, your Honor, that was supposed to be the third argument. So I wanted to focus on one and two.

THE COURT: We'll put that aside for now. That's not your strongest argument.

MR. FELDMAN: That's not the one I want to take up your time on this morning.

THE COURT: Go ahead.

MR. FELDMAN: So I wanted to start with the fraud allegations, the 10(b) and 17(a). And the point is simply that 9(b) requires fraud with particularity. And what we have here, we have vague allegations that fail to detail Ben Kirk's specific activities that group him together with others in ways that just fail to give a notice of the particular illegal acts that he supposedly took part in in his role.

And there's crutches here; rather than saying what Ben Kirk did, they group him -- the Kirks did this; Kirk, Boyle and Hinton did this; they and/or others did this. And we can go through some great -- all the examples here, if your Honor will allow us to do it, in a little bit. If you look at paragraphs 47 through 67 of the complaint, those are the key paragraphs dealing with Ben Kirk and with the Skymark operation.

THE COURT: But this isn't a group pleading. This is something different. Group pleading would be the defendant

said yes. To say John and Kirk did X means John did X and Kirk did X. I mean, sorry, I got it wrong. Ben did -- yeah.

MR. FELDMAN: Well, I think it turns on what you're saying. If you simply say -- if you have four defendants and you say "the defendants did X," I'm not sure that that's any different than taking four of ten defendants and saying, Ben, John, Hinton and Boyle did this. And that's what we have in here. So I think it is group pleading.

THE COURT: Well, it depends on what the allegation is. If the allegation is that Ben and John each drafted false documents, or each made certain representations, that's a different pleading.

MR. FELDMAN: Let's look at -- if your Honor would bear with me, we can look at a particular example or two, because I think these are the key allegations and these are the ones that my client should have notice of because this is what he needs to defend in this case. So, for example, paragraph 52.

THE COURT: Okay.

MR. FELDMAN: Ben Kirk and Boyle provided the account managers a script to use when calling investors.

THE COURT: Okay.

MR. FELDMAN: Now, we don't know what the script said. We don't know that anybody used it. This is supposedly a boiler room, so you're not calling investors. You're supposed

to be calling potential investors to get their money. It doesn't say when, if ever, they used the script or didn't use the script. It's a boiler room touting more than one stock, according to the story. So you'd expect multiple scripts on different days, at least two one on each of the stocks. Usually the way these work is you have a script that you use the first time, and then you get people and you get them interested, and then you have a second script. But we don't know what a script has to do with anything in this case.

THE COURT: But isn't the critical allegation here that he was the promoter, and -- I mean -- I'm sorry, that he was the principal of -- Ben Kirk was the principal of Skymark, and the promoter in Skymark, and he had a beneficial interest in the stocks that he was promoting, and he was representing that he didn't have a beneficial interest in the stocks? Isn't that the essence of the allegation?

MR. FELDMAN: That's the overarching story. But there's no details of any of that. So when you say he's promoting, it doesn't say he ever sent out an e-mail to any of the investors. It doesn't say he spoke on the phone to any of the potential investors. It doesn't say he told the phone callers what to say on the phone to the potential investors. It doesn't say that he pushed the button to cause somebody else to send the e-mail, cause Skymark to send the e-mail. It doesn't say -- it just -- yeah, I understand that theme, but I

want to be able to defend it, so I need notice of what he did wrong.

So, for example, it says Skymark had a database, and it said Skymark hired employees and Skymark sent out e-mails. Well, did Ben Kirk press the button to make those e-mails go? If he did --

THE COURT: It says the Kirks and Boyle drafted or approved the statements in the Skymark and the ESR stock autonomy.

MR. FELDMAN: That is the best allegation in the whole group, I agree. But know what? They put them all together, right? The Kirks and Boyle. So you have three people drafted and/or approved multiple misleading statements. So I'm not sure as to Benjamin Kirk; did he approve, did he draft? Did Boyle do the drafting or did John Kirk do the drafting? What did Benjamin Kirk do? Because I want to defend it. I want notice of what he did. And this putting three people together in the key statement and saying that they drafted and/or approved the statements? If he sent out the e-mails, then have an allegation that says Ben Kirk caused Skymark to send out those e-mails.

THE COURT: And what was the paragraph you were reading earlier?

MR. FELDMAN: We were reading 52 before.

THE COURT: 52. Right. Ben Kirk and Boyle provided

the account managers with script to use in calling investors. At times Skymark account managers called between 100 and 200 subscribers per day to tout either Trade Show or Pacific Blue stock. Ben Kirk and Boyle told Skymark accountants to watch the movie Boiler Room to learn how to promote stocks. In July 2009 Skymark announced coverage of Trade Show and sent the first of a dozen misleading e-mail blasts to his database of potential investors.

Now, even if I were to accept your argument that they could need greater, more specific allegations, this is the scenario that I have. I got Ben Kirk, who is pretty much -- I'll just concentrate on him. I think one could reasonably infer from these facts that Ben Kirk was a principal in Skymark; that he had a role in its creation and its operation; that he gave directions and drafted documents for the employees who were going to tout the stocks; that the employees were touting the stock that he owned; and that Skymark and pretty much everybody at Skymark knew or had to know that Skymark was holding itself out to be an independent research entity, okay?

Now, you know, these facts -- it may be a little vague on Mr. Kirk's knowledge, but I don't think, reading these facts, that one could reasonably conclude that he wasn't aware and wasn't partially responsible for those statements that it was an independent entity. It would be unreasonable to read this complaint and assume he's the only person that didn't know

that, okay? And knowing that, he owns the stock that is being touted by Skymark. And so he clearly -- if anybody knows, he clearly knows that any representation that his employees are told to make on behalf of Skymark that Skymark's people are independent researchers and that's why they're touting this stock and that there's no reason to believe that they have any interest in someone else buying the stock, because they will profit personally from that stock being sold; because when you tout the stock, it will hopefully go up in price. And so those who already hold the stock, including Mr. Kirk, will be able to sell it based on the increased interest created by Skymark when Skymark is claiming that it's independently assessing this stock and telling everybody how it's such a great deal, okay? Based on those facts, one could reasonably start out with a premise that Mr. Kirk is in an awkward position at best to argue that he was not responsible for any of these statements that were put out by his employees, and there were -- and some of them that they say were drafted or approved by him. Isn't that the essence of --

MR. FELDMAN: Your Honor, look, if we had had evidence and people testified, and we were now at the close of evidence and I was trying to argue to you that this shouldn't go to the jury because there's no facts and they can't take all these circumstantial inferences and draw them, that's a great argument you just made.

THE COURT: Yeah, but that would -- that's the easy --

MR. FELDMAN: That's not stating fraud with particularity.

THE COURT: No. You've got it backwards. If you were doing that, that would be an easier argument than the argument you're making now, because now you're just telling me I should assume on the basis of these allegations, assuming all of these facts are true, that they are not stating a plausible theory that your client is guilty of any pump and dump scheme.

MR. FELDMAN: Your Honor, this isn't failure to state a claim. It's failure to plead fraud with particularity. It's failure to give us notice of the fraud that Ben Kirk did.

So, for example, you said, okay, Ben Kirk had the employees do a bunch of stuff. But when you look here at 51, it says Skymark hired the employees. If Ben Kirk hired the employees, tell me that. Then I can determine whether, in fact, he did hire the employees, and I can defend this case.

THE COURT: Under the direct supervision of Ben Kirk and Boyle, Skymark account managers falsely told potential investors that Skymark was completely independent during telephone conversations and via e-mail, falsely portraying their organization as an independent research service. That's pretty specific. I was reading paragraph 59. That's the kind of stuff you're talking about, right?

MR. FELDMAN: Yeah, but that says these guys were the

managers, right? They were the midlevel supervisors.

THE COURT: Right.

MR. FELDMAN: It doesn't say they directed the account managers to give the false statements. They supervised them.

THE COURT: You think any reasonable trier of fact, if they were given these facts, couldn't conclude that Mr. Kirk -- particularly since he has the stock that's being touted in his back pocket and is ready to sell it when the stock is pumped up, that a reasonable jury couldn't conclude that he was in a position to have had -- to have known that he was going to be the beneficiary of these representations that his employees were making, that he was supervised? Are we supposed to assume he had no clue what the employees were telling the public?

MR. FELDMAN: I just want an allegation he did have a clue. I want an allegation --

THE COURT: It says they were under his direct supervision.

MR. FELDMAN: It says he supervised the people and they did the false statements. He supervised them, yes. He was their supervisor. And they made false statements. Now, if he directed them to do it, say so. If he gave them the script with the false statements, say so. They mention a script, but they don't say what the script said.

THE COURT: Well, you know, I'm not even sure that that would be required; because even if he didn't direct them,

if he is their direct supervisor, he is a manager of the Skymark and owner of Skymark. He knows that his employees are touting the stock that he owns, and he knows that they are saying that Skymark's research is independent of that. He knows that that is not true.

And he knows that the true representation would be that, no, we are not independent. The people who own us own the stock that we're trying to sell to you and will benefit from that stock. Does it really matter much whether he's standing over them at the time when they make those misrepresentations? Because you're not really reasonably arguing that these representations, based on these facts, could possibly have been made without his knowledge.

MR. FELDMAN: Your Honor, if I was drafting this complaint --

THE COURT: You probably would write --

MR. FELDMAN: -- I would have done it right, as it sounds like you would have. And it sounds like you would have tried to put down by interviewing witnesses who could say, "he told me to do this, that he told me to do it," right? That's how one builds a case.

But to put somebody through a federal court case on allegations of security fraud on vague statements that a group of people drafted an e-mail or that he handed someone a script without saying at all what the script said or that anybody used

it, or that he told people to watch a movie without saying what the purpose of telling them to watch -- you know, so they would know how to promote things? I mean, yeah, the movie is about exciting people on the phone promoting things. Does that mean they're told to lie? Is that the point?

If that's the point, say it. If he was telling people to get on the phone and lie to potential investors, make that allegation so I can defend it. That's all I'm asking for under 9(b). And it's not in here. It's pages of ambiguous stuff, groups of people, Boyle, Kirks all did this and/or that. And that's not the law under 9(b).

And I think the SEC could probably get it right, right? It sounds like from their motion, they rewrote it in the way they described his behavior. I'm sure they have good faith in the way they put it down in their opposition papers. Go back and get it right.

But I have the right to be on notice of the details and not these vague, overarching themes. And your Honor has picked up on those themes. And I agree that they are here, but that's not what I should be defending against.

THE COURT: Okay.

MR. FELDMAN: Second, your Honor, the same, the same allegations go to the SEC's fallback position. The SEC's fallback position is it's alleged Mr. Kirk had ultimate authority over Skymark. And, again, I don't think that this

complaint makes the allegation that Mr. Kirk had ultimate authority over Skymark. It doesn't show him actually running the operation, making the policy decisions. The best it shows is the one you pointed out; that he directly -- it says under his direct supervision account managers did things. And then it has a conclusion at paragraph 199. It says he exercised actual power and control through managing its operations, directing its strategy and possessing authority to execute documents. None of that is the kind of details that would show he has actual ultimate authority over this organization.

THE COURT: I mean, they say he's a stock promoter, principal of Skymark.

MR. FELDMAN: They don't say he's the principal of Skymark.

THE COURT: Yes, it does. Go to paragraph 21. It specifically says it. Says he relied on that. It's there.

MR. FELDMAN: Okay. So there they say that. But when you look at paragraph 198 --

THE COURT: You can't just go past that because that was just your argument. Your argument is that they didn't put him in a role as the principal of Skymark, so, therefore, it's insufficient.

MR. FELDMAN: I understand.

THE COURT: They did put him in as the role, both as the stockholder and principal of Skymark. So they put him

right in the suit.

MR. FELDMAN: I appreciate that, your Honor. But they also say at 198 that his brother is the sole director, right? So I'm not sure how he's the principal when his brother is the sole director.

THE COURT: What's inconsistent with that? Do you say that you can't have a director and a principal, and they'd be two different people?

MR. FELDMAN: I guess one could mean that, whatever that means.

THE COURT: And then, you know, I would assume Bill Gates is the principal of Microsoft. I don't know if he's a director.

MR. FELDMAN: Your Honor, again, the point I was making is regardless of them using the word principal, when you look at the facts and the particularities and how they back that up --

THE COURT: You're saying he had --

MR. FELDMAN: They said he supervised somebody.

THE COURT: He has overall supervision of those people who were promoting stock.

MR. FELDMAN: It says -- he supervised account managers with somebody else. That doesn't mean he's the ultimate authority.

THE COURT: Well, who else is the ultimate authority?

MR. FELDMAN: I don't know who else, but that's what I'd like them to detail, the ultimate authority.

THE COURT: Ultimate authority to do what?

MR. FELDMAN: To run that organization.

THE COURT: Why does that matter?

MR. FELDMAN: That was their fallback argument.

THE COURT: That's not --

MR. FELDMAN: That's their argument.

THE COURT: Even if he's not the ultimate authority, that's not determinative of whether or not he's involved in the scheme and fraud.

MR. FELDMAN: What they're saying, your Honor, is that he is on notice of bad statements because he was the ultimate authority of Skymark and, therefore, anything that they say Skymark did can be attributed to him. And I'm saying as a matter of law, they haven't detailed him hiring the employees, firing the employees, signing the lease, controlling the bank account, any of the kinds of things that would actually show that he was the ultimate authority of that institution.

THE COURT: But, I mean, in most complaints that detail isn't in the complaint. They don't have to -- they don't have to give me that kind of detail.

MR. FELDMAN: If they're using that as their argument as to why their allegations are sufficient, they need those details.

THE COURT: No. They say Mr. Kirk is the -- the Kirks and Boyle drafted and/or approved multiple false, misleading statements in Skymark and ESR stock accounting e-mails, including the representations that Skymark and ESR employees and associates were independent and did not hold any position of beneficial interest in the promoted company. Now, you can attack that as group pleading, but you can't attack that as a lack of specificity.

MR. FELDMAN: I'm sorry, your Honor. Which paragraph is that?

THE COURT: I'm sorry. I was looking at 51.

MR. FELDMAN: Sorry. I'm not keeping up with you.

THE COURT: And then it concludes saying these Skymark employees called account managers, worked under the supervision and control of the Kirks, Boyle and Hinton. And then you went to give me the script, and then you gave me the Boiler Room movie. And then -- I mean, remember, this is a scenario I have. Given the nature of that relationship, whatever the detail of that day-to-day relationship is, then on July 24th of 2009, Skymark announced coverage of Trade Show and sent the first of dozens of misleading e-mail blasts to its database of potential investors.

Now, I would have to assume at that point, despite all his total involvement, he has blinders on or he doesn't know this was going on.

MR. FELDMAN: All I want to know is who had Skymark do that. Say that.

THE COURT: Why is that critical?

MR. FELDMAN: That's fraught with particularity, your Honor. It is. The people, the who, what and where of who caused the fraudulent actions take place --

THE COURT: No. That's not the critical part of what keeps him in the suit.

What keeps him in the suit is a reasonable inference that he knows that it's being done. He doesn't have to be the one that necessarily directed them to do it, because he knows that it's being done and it's being done to benefit him personally. And he's supervising all of these people. And if they're doing it, I don't care if his brother told them to do it. If he's sitting there and they say, "we're getting ready to put this out," and he goes, "no problem," I mean, he doesn't get to do that.

MR. FELDMAN: If they make those allegations, those are great. We have no allegation in here about who was running the e-mail system, right? They say he was the manager of the guys on the phone.

THE COURT: So am I supposed to infer from this that he doesn't have a clue or he does have a clue?

MR. FELDMAN: You're supposed to infer that fraud with particularity requires them to tell me what the details are so

my client can have notice of them and respond.

THE COURT: I'm trying to figure out what it is you say -- you say that you don't know what they claim that you say that you need to know in order to defend against the -- to answer this complaint.

MR. FELDMAN: I don't know what they claim Ben Kirk did in particular that was fraudulent.

THE COURT: You know they claim that he helped set up Skymark so that they would have a vehicle to tout stocks, and he participated in the decision to decide to tout the stock that he owned --

MR. FELDMAN: It doesn't say that, your Honor.

THE COURT: It does say that.

MR. FELDMAN: Where does it say he participated in the decision to tout the stock?

THE COURT: It says dozens of e-mails that De Beer was reporting to and taking instructions from the Kirks demonstrate that De Beer and the Kirks engaged in almost daily stream of communications between Trade Show -- regarding Trade Show press releases, potential business announcements and contacts with investors. For example, John Kirk drafted a press release for De Beer to release on behalf of Trade Show and sent e-mails to De Beer. And in September and October the Kirks and Boyle wired De Beer over $330,000 from Trade Show. By at least April of 2009, the Kirks were planning a new promotion of Trade Show

in order to increase the stock price from trading bottom.

Now, you want to say, oh, well, that could be John Kirk, not Ben Kirk, I mean, I understand that argument. But you can't say they didn't allege that Ben Kirk planned a promotion of Trade Show in order to increase the stock price from trading bottom. That's exactly what they allege.

MR. FELDMAN: But what that means, your Honor --

THE COURT: The details --

MR. FELDMAN: The promotion is, what, they ran infomercials? What does planning a promotion mean? I just --

THE COURT: They train -- they helped draft scripts. They approved statements. And the e-mails, they approved the statement that -- and helped draft the statements indicating that Skymark was independent and did not hold any position of beneficial interest in promoting companies? That's what paragraph 50 says.

MR. FELDMAN: No paragraph says they drafted scripts. For example, there's no paragraph in there. It says Ben Kirk provided a script on one occasion.

THE COURT: It says the Kirks and Boyle drafted and/or approved multiple false or misleading statements in Skymark and ESR stock touting e-mails, including the representation that Skymark and ESR employees and associates were independent and did not hold any position of beneficial interest.

MR. FELDMAN: Right. So we have that one paragraph

that three people drafted and/or approved the e-mails.

THE COURT: Ben Kirk and Boyle provided -- and that's more specific.

MR. FELDMAN: Ben Kirk and Boyle provided a script.

THE COURT: Right. Provided --

MR. FELDMAN: A script.

THE COURT: -- a script to use when calling investors.

MR. FELDMAN: Right. What did that script say? Does it have lies in it? I'd like to know. If it did, that would be great, because then I could try to locate that script and try to defend it.

THE COURT: Well --

MR. FELDMAN: That's what fraud with particularity is. That's what 9(b) requires. That's all I'm asking the SEC to do, is live up to 9(b).

THE COURT: Okay.

MR. FELDMAN: Your Honor, then the last point -- I want to be quick because I've taken up more than enough time -- is under 20(a) the SEC has alleged that Mr. Kirk has control person liability. Your cases, your Honor, require that the plaintiff allege meaningful culpable participation in the control person's acts of frauds. Meaningful culpable participation. Then you've gone on to say that allegations are insufficient for 20(a) where they fail to allege any particularized facts indicating that a defendant had actual

control over the statements that were made or otherwise played some discernible role in making those statements. And apart from 50, right, which is this group pleading, that's the best of Mr. Kirk having control over the statements.

THE COURT: Well, you have to use some other paragraphs to -- take, for example, 59. That's the nature of that allegation. It may not be particularly specific as to how and why, but that's the nature of that allegation. 59.

MR. FELDMAN: The nature is that he was a supervisor of people who made false statements.

THE COURT: No, that's not right. No. It says, under the direct supervision of Ben Kirk the account managers made false statements.

MR. FELDMAN: Again, they should just tell us what that means. Does that mean he told them, say this on the phone? If that's what it is, great, let's hear it.

THE COURT: Well, but they did say it. They said that he was one of the individuals who drafted and/or approved statements that falsely portrayed the organization as an independent research service.

MR. FELDMAN: Right. That's what they say. The Kirks and/or -- the Kirks and Boyle drafted and/or approved multiple false and misleading statements. That's right.

THE COURT: And the nature of those false and misleading statements included the kind of statements in 59.

There's no other way to read that.

MR. FELDMAN: I don't disagree about independence. I'm not sure how that helps in terms of the SEC having to provide -- he provided -- having to provide -- that they've alleged meaningful culpable participation in the control person's acts --

THE COURT: Well, it helps if it's supposed to mean, and reasonably does mean, that he was structuring this organization and managing these people in such a way and approving and drafting statements in a way so that these individuals under his supervision would mislead the public into thinking that they were touting -- they were an independent research service touting a stock in which none of the principals of the research service had any interest. And the purpose of that, the reasonable conclusion, is that when they pump up the stock, then Mr. Kirk could sell his and he will get an artificially inflated price above what he paid for it because people would not know that the people are saying this is a good buy at this price. Other people who are on the other end were going to make the profit when you pay this inflated price for the stock.

MR. FELDMAN: I understand the theme, your Honor. We're on the same page that the SEC has a theme here. But it's not a particularized fact indicating that Mr. Kirk had actual control over the statements. What we have here, at best, under

50 and 59, for example, the ones you pulled out is Mr. Kirk is a guy who writes PR. He writes the false e-mails. That doesn't mean he controlled the organization.

THE COURT: Well, he doesn't have to -- okay. We're just concentrating on the control.

MR. FELDMAN: I'm concentrating on 20(a). Under the 20(a) liability --

THE COURT: Well, what do you say -- let's separate the illegal activity from the control activity. What is it that you say his role was here that takes it out of the definition of having control, given the nature of how they describe his involvement from beginning to end and his supervision of all of the employees in this organization?

MR. FELDMAN: I take from reading this complaint that they've alleged with facts -- not with broad conclusory statements, but with facts -- that Mr. Kirk is a midlevel manager who writes PR.

THE COURT: Well, on what basis would you -- what language would make you put him down to the midlevel?

MR. FELDMAN: Because he's a direct supervisor of the guys on the phone.

THE COURT: No. He's a principal.

MR. FELDMAN: You're going back to that, to the broad allegation in the beginning. I'm talking about the facts of what it says he did, right? The particular facts --

THE COURT: I don't know where you get midlevel from.

MR. FELDMAN: I get it from paragraph --

THE COURT: I mean, nobody -- who's on the top level?

MR. FELDMAN: I would think the CEO, right?

THE COURT: Who's that?

MR. FELDMAN: Whoever that is.

THE COURT: What makes you think there's somebody above him?

MR. FELDMAN: I'm guessing, because this is the SEC's complaint, right, Judge? So I'm looking for particularized facts about where Mr. Kirk figures into this organization.

THE COURT: You characterized him as a midlevel employee. And there's nothing in this complaint that characterized him as a midlevel employee. Everything in this complaint is trying to characterize him as a principal and a high-level employee.

MR. FELDMAN: That may be what they're trying to do, Judge, but, again, when you focus on the actual facts and the details of what they said he was doing day in and day out in his job, he is supervising people making phone calls.

THE COURT: He's supervising everybody.

MR. FELDMAN: A phone call. I don't know if that's everybody. Apparently there's an e-mail, too.

THE COURT: They say he drafted the e-mails, that he approved the e-mails.

MR. FELDMAN: They don't say he sent them out. We don't know who sent them out.

THE COURT: The secretary may have sent them out.

MR. FELDMAN: Maybe. Did he supervise the secretary? When you're saying he supervised everybody, those facts aren't in here.

THE COURT: There's no facts that limit his control or position in this company.

MR. FELDMAN: There's no facts that say he, in the day in and day out, exercised the ultimate authority; that he signed the lease; that he paid the paychecks; that he did the kind of things that would be the control person liability under 20(a). That is my point. And the SEC perhaps can allege those. If they do a do-over, and I think they should, then that's the kind of notice we're required to get.

THE COURT: All right. So what do you think that they're trying to say what his role was?

MR. FELDMAN: I know what they're trying to say, Judge. You know what they're trying to say. They just haven't said it. And their responsibility in filing a complaint is to say it. It's not to try to say it. And I just want them to say it.

THE COURT: And I assume you would want them to say something like John Kirk is the sole director of Skymark, and Ben Kirk and Boyle ran its day-to-day operations?

MR. FELDMAN: I'd like them to say better than that.

THE COURT: That's what they said.

MR. FELDMAN: I'd like them to say, what does that mean when you get to the particularized facts?

THE COURT: You can't do that. That, you can't do. You can't -- you know, as they say, I always tell the lawyers you can't make the argument on this kind of motion that, yeah, they said he did it but they don't tell us exactly how. Because then you keep moving the mark. If they say he ran the day-to-day operations, you can't just say, "well, they don't say how." And then they said, "well, we say how because he was their direct supervisor."

Ah, but they didn't say how he supervised.

Oh, well, he supervised because he did --

Well, they didn't say how.

I mean, you could take that argument any way. He ran the day-to-day operations. Now, that is a -- you think that that's an insufficient allegation to put him on a level that is other than, as you would call, a midlevel manager?

MR. FELDMAN: Your Honor, I think that if that allegation standing alone is enough to put somebody on the hook for 20(a) liability --

THE COURT: That's not the only allegation.

MR. FELDMAN: Right, but that's the one allegation of what his role was, that --

THE COURT: No. That's not the one allegation. I added that to the other allegations that you say alone were insufficient.

MR. FELDMAN: So you have day-to-day operations with another guy. You have another statement where he directly supervised his account managers.

THE COURT: You have another statement that says he's a principal. You have another statement that says he drafts and/or approves the false -- the e-mails. You have another statement that said he drafted the scripts.

MR. FELDMAN: No, a script. No, you don't have that.

THE COURT: I take that back. Drafted a script.

MR. FELDMAN: Not even drafted; provided a script. Not even drafted. Your Honor, the conclusion of all this is those -- you've taken vague statements: He ran day-to-day operations; he was a principal. You've taken then specific statements: He manages the phone callers and he, with a group of others, wrote some e-mails that were false. That's not, taken together, the allegation that makes a legal standard of particularized facts that he had actual control over the statements that were made or, you know, actual control over this entity.

THE COURT: Well, I mean, other than having day-to-day control of the day-to-day operations and supervising the people who are making the false statement and providing them a script

and --

MR. FELDMAN: Which we don't know what it said.

THE COURT: Right. I'm not even using that as any evidence of wrongdoing. I'm just using that as evidence of control. If he provides them a script, I assume the person who provides them the script is -- unless they say he was told to do that by somebody else, in combination with what they say his day-to-day operations were in the supervision, that he has the authority to do that.

MR. FELDMAN: Again, the person who provides the script is probably the guy who manages that group of people. That doesn't mean he --

THE COURT: No. It's not probably that, because you want me to assume there's supposed to be some other layer of operation here that they don't say that --

MR. FELDMAN: I have no idea how many layers there are.

THE COURT: Right. You only have the layers that they give you in this complaint, and they only give you one layer. They say he's the guy responsible for the day-to-day operations. His brother is the guy who -- he and his brother own the company, and that they -- he's responsible for the day-to-day operations. And it's reasonable to conclude that these statements that they are putting out, he knows that those statements are false because he knows what his beneficial

interest in the company is, and he knows that he will benefit from the touting of this stock; and benefit more significantly from not letting the purchaser know that he, the principal of Skymark, the person responsible for its day-to-day operation, the person who's supervising all these people who are giving you this information, is the one who's going to make the profit. That's a serious allegation, you understand? It's an allegation of a pump and dump scheme.

MR. FELDMAN: I certainly understand the overarching theme, and you've done a good job of explaining it again. But I don't think, as I've argued, that those are the kind of particularized details that are required under the legal standard. And I think that by -- for example, you said he and his brother ran these operations. But when you look back at paragraph 47, it's four people who set up the boiler room. It's the Kirks and Boyle and Hinton, right? So these allegations are always grouping everybody together and not giving the actual detail that it would be nice to have separated out the way your Honor did it. But that's not what the SEC did here.

THE COURT: But I have to take certain inferences from the facts. And I can make a reasonable inference that it's a coincidence that John Kirk is the sole director of Skymark, and his brother Ben Kirk and Boyle ran its day-to-day operations. And Ben Kirk supervised the people who they claim were making

the false statements and approved and/or drafted those statements.

MR. FELDMAN: I'm not suggesting whether you should draw or not draw inferences on things, right? What we come down to here is whether they've pled the requisite particularity to meet the --

THE COURT: But it also includes the reasonable inferences that's supposed to be drawn from the facts as they allege them. And you're sort of arguing that, well, I know what they mean. I just want them to say it a little bit more specifically, even though I know exactly what they're accusing us of, and we could either deny it or admit it.

MR. FELDMAN: You know how a boiler room worked and I do. So I certainly know what they think goes on here. But what they think goes on in the boiler room and what you and I think goes on in the boiler room and what goes on like we see in the movie Boiler Room that they mention here --

THE COURT: I never saw the movie.

MR. FELDMAN: -- doesn't tell us the kinds of facts that put an individual on notice to defend the kind of fraud that's alleged here. And that's what we're asking him to meet up with.

THE COURT: Thank you.

MR. FELDMAN: Thank you.

THE COURT: Yes. Let's begin. I'm having the marshal

bring up a prisoner. We're in between a plea, but I didn't want to waste time. So let's talk about Mr. Hinton.

MR. SALLAH: Thank you, your Honor.

My name is Jim Salah. I represent, and my firm represents Mr. Hinton in this matter.

Your Honor, I've read through the transcript from the last session and all sorts of talk about Mr. Boyle and the Kirks and others. Mr. Hinton's name, other than in introductions and so forth, was mentioned less than a half dozen times. And if you review the complaint, 50-page complaint, the SEC spent years investigating the matter. There's 171 factual allegations excluding the counts, which, total them up, it's almost 250.

There's approximately a dozen paragraphs where Mr. Hinton is mentioned. Some of the paragraphs, your Honor, refer to him in passing reference or as part of a group. Others are innocuous. There's not a single misrepresentation attributed to Mr. Hinton. In fact, there's no allegations that he reviewed, drafted or approved any public filing or had any editorial control over it. There's no allegations that he drafted, reviewed any scripts or press releases or anything else. In fact, there is not even a suggestion in here that he is aware that any of the information that was put out to investors or the public or potential investors was false or misleading. In fact, going back and forth with Mr. Feldman a

minute ago about paragraph 59, he's not even alleged to have supervised any individuals.

So Mr. Hinton finds himself here accused of fraud based on some scant paragraphs in a complaint that fall far short of 9(b).

I typically practice down in Florida. I don't practice here. I'm a guest here in the courtroom. But there's a great quote that we use, and it's from the Southern District, and it talks about when considering 9(b) -- because 9(b) is not so much for the Court; it's for the defendant to be able to identify and be able to kind of craft arguments in an answer based on allegations. And it says, broad allegations that several defendants participated in a scheme or conclusory assertions that one defendant controlled another or that some defendants are guilty of their association with others do not inform each defendant of its role in the fraud and do not satisfy Rule 9B. This type of clumping of defendants together and vague allegations of fraud is the very type of inadequate pleading that Rule 9B seeks to prevent.

So we don't have any misrepresentations attributed to Mr. Hinton. So the best we can do, I guess, is craft, or at least the commission can craft, is a scalping case against him. And it says under scalping, it basically says, your Honor, if somebody's recommending a security, they need to disclose that they have an interest in that security. And they're selling

it.

Now, things change a little bit after the Supreme Court case in *Chiarella*, because in *Chiarella* the Court said only those who have a duty, a duty in an omissions case, have to speak, have to disclose their interests. So if I walk into a New York subway and I start telling people to buy IBM stock, even if I'm getting paid to do it, I don't need to disclose that if I'm -- or if I've got stock and I'm selling it, unless I owe a duty to someone who's listening to me, my audience.

Now, if you look at the complaint against Mr. Hinton, there's a couple statements that are made. It says, with respect to Skymark, it says -- I'm sorry. It says Mr. Hinton promoted Trade Show to multiple -- this is paragraph 61 -- to multiple investors and made calls to investors to promote the stock while working with Skymark and ESR. He misled those investors by failing to disclose his ownership in the promoted companies and lack of independence. What is his obligation to do so? What duty does he owe?

This is in the *Park Financial* case. They cite in their response *SEC v. Park Financial*. That was a case referred to as the Tokyo Joe case out of Chicago. And in that case the commission in its complaint took pains to create a duty, a duty. They talked about that people paid a subscriber's fee to Tokyo Joe's website, that he would give them personalized advice in chat rooms, and they went on and on about all the

personal service that he provided. This is nothing more than an arm's length transaction. We don't even know who these investors are. Do they have some prior relationship with Mr. Hinton? Did he talk to him on other occasions, or is this just an individual trying to promote a stock to somebody else? Where is the duty that he owes to that individual?

Now, they also said in the *Zweig* case -- *Zweig* predated *Chiarella*. Zweig was someone who was an author of newspaper articles. And in *Zweig*, the newspaper, the analyst that would provide analysis in his newspaper articles was sued. And this was in the Ninth Circuit case. And the court in that case said, well, you do have a duty. If you decide to speak and you're selling a stock, you kind of take on the duty to disclose your interest in the stock and what you're doing with it, particularly if you're selling it.

However, that case was subsequently questioned by *Feldman*, which was another Ninth Circuit case which postdated *Chiarella*. And it says -- and it limited *Zweig*. And it said, when there's a financial advisor, when one is giving advice -- which was what *Zweig* did; he was an analyst that wrote for a newspaper. And, again, even in that case the Court found the columnist had a duty to his readers because he was a, quote, informal advisor, controlling -- kept secret the information he owned the stock. He was a salary columnist and he benefited from his relationship. The column initiated many stock

transactions and so forth. He had a relationship.

Here, no relationship is alleged. And I'm not sure if the SEC can allege relationship. And that goes for emotion and is based on 12(b). The promotion of Trade Show and the duty there is even more bizarre and more attenuated. Hinton promoted Trade Show to multiple investors and made calls to investors to promote the stock while working with Skymark and ESR. He misled these investors -- I'm sorry, Pacific Blue. I apologize.

Mr. Hinton offered to sell a block of Pacific Blue to an investor in the US in a private transaction. While offering this block, he failed to disclose he and other defendants were allegedly dumping their shares into the increased demand created by the promotion. Well, obviously, if he's offering to sell stock to somebody, he's selling the stock. Now, if he's selling somebody else's block, they don't say that. But moreover, even -- and, again, there's no allegations that he sold. There's allegations that others sold on his behalf. That's another thing, your Honor, to further kind of put things in context.

If you read the complaint as drafted, there were 21,000 shares, or $21,000 of the $11 million worth of stock that they say that Hinton and the Boyles and -- or Boyle and the Kirks sold. Less than one-third of 1 percent apparently was owned by Mr. Hinton. They sold $21,000 worth of Trade Show

stock and $12,000 worth of Pac Blue. I would venture to say that our last hearing, the billable hours by the attorneys in this courtroom would probably equal the amount apparently from this huge pump and dump.

Moreover, it doesn't even say he sold the stock -- scalping, you have to have selling -- or that he was aware of the selling. It says, and if I can get to it, Mr. Hinton realized proceeds of more than $21,000 and received at least $31,000 in proceeds from the sales of Ben Kirk controlled accounts.

THE COURT: I'm sorry. Where are you reading from?

MR. SALLAH: I'm sorry. That's in paragraph 160.

So I'm here for Mr. Hinton trying to figure out what exactly it is that he did to defraud anybody. I don't see any misrepresentations attributed to him. I don't see where he had any editorial control or directed anybody. I don't even see that he was aware of any misrepresentations.

And moreover, your Honor, with regard to the scalping claim, I don't even think it satisfies 12(b) -- I don't think it survives the motion to dismiss on a 12(b) standard because they never pled existence of a duty. I don't know what facts would give rise to a duty that Mr. Hinton was acting as a financial advisor, because that's what scalping kind of grew out of, the scalping cases were investment advisers, capital gains research and some of the older cases, where there was a

fiduciary duty established between the person giving the investment advice and the audience, and undisclosed to those individuals that the investment advisor was selling a stock. And we've seen it grow a little bit in the Tokyo Joe case, where they said, well, you can be an informal advisor. But in those cases the SEC has gone at lengths to plead kind of what gives rise to that fiduciary relationship; because absent a fiduciary or other relationship, other special relationship, there's no duty to speak of.

Now, turning to the 20(a) claim, your Honor, not really sure exactly what Mr. Hinton -- I know they do -- there is an allegation that he set up boiler rooms, whatever that means. I don't know if that means set them up from the ground and that he was involved in the day-to-day operations. There's got to be something more than participation. There's got to be culpable participation, as your Honor, I think, pointed out. What was culpable about his participation if he's not aware? There's no allegations he's aware that there's any wrongdoing afoot or that someone's done anything inappropriate regarding scripts or sitting down or forcing brokers to watch -- salespeople to watch Boiler Room. He's not alleged to have been involved in any of that conduct.

So, again, with respect to the 20(a) claim, your Honor, we're also at a loss as to what is culpable participation, absent just this fleeing mention of the fact he

was involved in the day-to-day operations, and at one point he identified himself as a director. But that point, your Honor, if you'll notice in the complaint, postdated the Skymark promotion. Wasn't until 2010.

And he was never a legal director. There's no allegations of that. And we don't know to whom he said he was a director. Was it to somebody in a bar, to impress somebody he was talking to? I don't even know what that means, that he said he was a director. And being a director in and of itself -- and there's some cases we cited in the Second Circuit -- isn't enough to rise to the level of a culpable participant.

Moreover, they haven't alleged that he's owned more than 10 percent of the stock, which clearly he didn't make that much, so there's no assertions there. But by virtue of his ownership, he was some kind of a control person.

So thank you, your Honor. I'm open to any questions.

THE COURT: No. I want to inquire first of the SEC.

MR. SALLAH: Okay.

THE COURT: Let me take a short break. I need about 10, 15 minutes, and bring out the prisoners. If you could just, particularly the back table, clear out the back table so the marshals can get there.

MR. BRODY: Can we leave some of the stuff here, your Honor?

THE COURT: Front table, you can. Just clear half of the back table.

(Recess)

THE COURT: Yes.

MR. BRODY: Good afternoon, your Honor. My name is Todd Brody. I represent the SEC in this matter. And with me today also representing the SEC are Katherine Bromberg and Joshua Newville.

It's a little difficult for us to address all of the -- there's a lot of arguments that the defendants made, your Honor. So in attempt to address these efficiently, I'm going to address the fraud claims that we have brought against the defendants in this case, and that would include the aiding and abetting and control person liability claims. Ms. Bromberg will then address the Section 5 claims. And then when she is finished, Mr. Newville will address the jurisdiction, venue and process issues, to the extent that your Honor wants argument on those issues from the SEC.

As a preliminary note, your Honor, the SEC believes that the allegations in the complaint are sufficient against all defendants on all counts. However, if the Court disagrees in whole or part, we respectfully request leave to amend, because we do not believe there are any inherently failed defects in the claims that the SEC has brought.

THE COURT: Let me organize you in a little different

manner, because I want to first take it defendant by defendant. And I'd like to first start with where I have my greatest concern. And I don't know if that's what you intended to address personally, but let's first talk about Dr. Carillo.

Obviously your complaint is -- I'll characterize it as artfully drafted around Dr. Carillo. Tell me, first of all, what's your jurisdiction, and then tell me what you say he did.

MR. BRODY: If I may, your Honor. I'm going to hand this over to Mr. Newville, who's going to address Dr. Carillo and the jurisdictional issues.

MR. NEWVILLE: Thank you, your Honor. Josh Newville with the SEC.

As to Dr. Carillo, his counsel asserts that we've failed to allege that he either purchased or sold shares. We believe that assertion is incorrect. And the Court asked, when we were here last, whether there's any allegation that Dr. Carillo took any active role in the acts alleged. Let me just go through, because these issues are kind of combined. And we're charging Dr. Carillo with a Section 5 violation, which has a slightly more limited pleading requirement than the fraud charges.

THE COURT: Well, before you get to the substance of the charge, what's your jurisdictional --

MR. NEWVILLE: He's subject to personal jurisdiction because he took acts that had a foreseeable and direct

consequence in the US.

THE COURT: What acts are those?

MR. NEWVILLE: Let me just go through in the complaint.

Paragraph 79, Dr. Luis Carillo contributed $20,000 of the purchase price for the Pacific Blue shell that was an act through the Carillo Hotel Trust account, through a US law firm and a US bank account.

THE COURT: I'm sorry. Say that again, because that's not in the complaint. Where were you just --

MR. NEWVILLE: Paragraph 79.

THE COURT: You say -- it says Dr. Carillo contributed $20,000.

MR. NEWVILLE: Right.

THE COURT: It says John Kirk contributed $200,000 of the purchase price for the Pacific Blue shell, and Dr. Carillo contributed $20,000. I don't know what that means. You were giving me some more, but the rest of what you're giving me is not in this complaint.

So tell me, what's the basis of the jurisdiction -- in what way did he contribute $20,000 that gives jurisdiction over him? He's a Mexican citizen?

MR. NEWVILLE: He wrote a check.

THE COURT: I'm assuming you're proceeding on the presumption he's a Mexican resident, and you're not alleging

that he came to the United States and participated in any of the other activity that you're alleging, not alleging.

MR. NEWVILLE: We're not alleging his location at any point in time. We think it's irrelevant to the claims that we've alleged, which are simply based on the effects that those acts had in the US.

THE COURT: So you're not alleging that he came to the United States and took any acts over which his presence in the United States would give you jurisdictional?

MR. NEWVILLE: We're not sure where he was located at the time he took these acts.

THE COURT: Okay. Well, the answer to my question, then, is no?

MR. NEWVILLE: Right. We have not alleged that in the complaint.

THE COURT: Okay. So you're alleging that he did what act? What is the act that you say gives you jurisdiction? When you call the act that he contributed $20,000, what does that mean?

MR. NEWVILLE: Right. He contributed $20,000 to purchase shares in a US company.

THE COURT: So what did he do?

MR. NEWVILLE: He paid $20,000 in shares.

THE COURT: To whom, where, what? I mean, tell me what that means. When he could have contributed -- he could

have given $20,000 in an envelope to his son when he was in Mexico City. You're saying that that would give you jurisdiction?

MR. NEWVILLE: No. I'm not addressing that.

THE COURT: Tell me what he did. Tell me what he did.

MR. NEWVILLE: He wrote a check from a US bank account to another US bank account.

THE COURT: Okay. That's --

MR. NEWVILLE: That was his son's law firm's trust account.

THE COURT: He wrote a check because -- again, this is not in the complaint, so that's why I'm asking. He wrote a check on a US bank account?

MR. NEWVILLE: That's right.

THE COURT: And that check --

MR. NEWVILLE: That check was written to the Carillo Huettel law firm.

THE COURT: To the law firm. All right.

And what is it about that -- you would not say just in the abstract that that would be sufficient presence or transaction of any business that would be a basis to assert jurisdiction over because he wrote a check on a US bank; that's not the basis on which you're --

MR. NEWVILLE: No. We're asserting the basis is that the check was for the purchase of shares in a US company. And

through that purchase, he became an owner, a partial owner of a US company.

THE COURT: Okay. So why does that give you jurisdiction? You have jurisdiction over everybody who buys a share of a US company?

MR. NEWVILLE: No, but in the context of this case, there are additional allegations as to Dr. Carillo.

THE COURT: Okay. I'm just trying to understand your legal theory first. What's the legal theory that his writing a check on his US bank account to purchase some shares in -- and that was to purchase shares in Pacific Blue?

MR. NEWVILLE: Right.

THE COURT: To purchase shares in Pacific Blue. What about that act gives you jurisdiction over him if he's in Mexico?

MR. NEWVILLE: Because as an investor in a US company, one would expect that you have an interest in a company that's acting in the US. And we haven't only alleged that he purchased shares; we also allege that he sold shares in that company.

THE COURT: Well, if you want to go there, I'm not finished with the purchase. But in what way do you allege he sold shares? Because that's not the way I read the complaint. I read the complaint that he gave his son power of attorney over his shares and the son sold the shares. That's what I

would read from the way you wrote it. You clearly deliberately avoided saying that he personally sold the shares. You wrote it. Because if you wanted to say that, you could have clearly stated it. It's clearly that you knew you couldn't say that. You know, you're not alleging that he personally sold the shares or even that he directed that the shares be sold. You're not alleging that, right?

MR. NEWVILLE: No, your Honor. We were informed that both Carillo, the son, and Dr. Carillo provided instructions to the account, but we could not pinpoint who made the instruction to sell these shares.

THE COURT: But you're not relying on that; his active participation in selling the shares or active decision to sell the shares, you're not relying on that either for your purpose of jurisdiction over him or for the purpose of alleging that he participated in a scheme?

MR. NEWVILLE: Well, we don't allege that he participated in the scheme. The Section 5 claims are fairly limited. Really all we need to do for those types of claims is allege that he sold shares, and we have in a couple of paragraphs.

THE COURT: Well, you've got to allege more than he sells shares. Everybody sells shares. So that's not a Section 5 violation, just selling shares. So what are you accusing him of doing? That's what I'm trying to understand.

MR. NEWVILLE: Right. He sold shares that were not registered.

THE COURT: Okay.

MR. NEWVILLE: We've also alleged that it was in the -- through the means of interstate commerce. Those are the prima facie elements that we need to plead in order to move forward on a Section 5 claim.

THE COURT: You don't say he sold shares.

MR. NEWVILLE: If I could, your Honor.

THE COURT: Show me the paragraph, because I looked for that specifically. And the paragraph that comes closest to that seems to deliberately avoid saying that he sold the shares. So point me to the paragraph that you're relying on that says he sold shares.

MR. NEWVILLE: Paragraph 148 of the complaint, your Honor.

THE COURT: Okay. 148 says the Kirks, Boyle and Hinton and Dr. Carillo sold means of Pacific Blue share within a one-year period. You're saying Dr. Carillo sold means of Pacific Blue shares?

MR. NEWVILLE: In fact, he sold over a million Pacific Blue shares.

THE COURT: Well, you don't mean to say millions. That's not what you mean by him. Because it says the Kirks, Boyle, Hinton and Dr. Carillo.

Now, what is the factual basis for saying he sold the shares?

MR. NEWVILLE: The shares were in his name.

THE COURT: Okay. I understand that.

MR. NEWVILLE: They were sold through his brokerage account.

THE COURT: I understand that.

MR. NEWVILLE: The funds went from that brokerage account to his bank account.

THE COURT: Some of the funds.

MR. NEWVILLE: We believe the majority of the funds went to his bank account in Mexico.

THE COURT: I thought the majority of the funds were distributed through -- some through the trust fund for the firm and were distributed to the other principals you allege in this scheme. How much money do you say went to him personally in Mexico?

MR. NEWVILLE: I believe it was over 900,000 that went to him in Mexico. We don't allege that in the complaint.

THE COURT: Right. That's what I'm trying to understand, what you're saying he did. Are you saying he made the decision to sell these shares?

MR. NEWVILLE: We don't know which of them made the decision to sell these shares. But we know that he gave trading authority over the account to his son, who is a US

citizen and US resident.

THE COURT: And you think that that's a basis for asserting jurisdiction over him, because he gave trading control to the son?

MR. NEWVILLE: I believe in the context of his other actions that he took that had direct and foreseeable effects in the US, yes, it does.

THE COURT: What are the other actions he took? Again, I'm asking these questions out of ignorance. It's not in the complaint. What are the other actions you say he took? Because this is what I get from the complaint, and you can tell me -- I want to make a big distinction between what you think happened and what you say happened. What you say happened is that the son created an account for him, no?

MR. NEWVILLE: No, your Honor. We don't say the son created the account. We say it was his account, and at some point Dr. Carillo gave trading authority and power of attorney over that account. He didn't relinquish control over the account.

THE COURT: Okay. So you say that this was already an existing account that he set up to trade in US shares?

MR. NEWVILLE: We don't allege anything about when the account was set up.

THE COURT: Well, by whom? I'm not asking about when. By whom? See, again --

MR. NEWVILLE: The account was set up by Dr. Carillo.

THE COURT: It was set up by Dr. Carillo?

MR. NEWVILLE: That's correct.

THE COURT: And what does that mean?

MR. NEWVILLE: That means he signed the account opening documents to open the account.

THE COURT: Okay. He signed the account opening documents for what kind of account?

MR. NEWVILLE: The trading -- it was a securities trading account.

THE COURT: Okay.

MR. NEWVILLE: And the way it was used in this instance was simply to dump over a million shares of Pacific Blue stock for proceeds of over $1 million.

THE COURT: Well, again, they're right when they argue that that's a fairly sweeping statement. I want to know what -- I'm trying to figure out both the jurisdictional purposes. You say you have jurisdiction over him because he had a US account in the United States. He bought shares in Pacific Blue. Those shares were sold and moneys were sent to him as a result of selling those shares and moneys were sent elsewhere.

And you say that -- again, just give me the legal theory. The reason why you have jurisdiction over him is because he did what?

MR. NEWVILLE: I think the sales of the shares in and of themselves are enough to provide jurisdiction.

THE COURT: The sale because why? What's the legal theory that selling shares gives jurisdiction over --

MR. NEWVILLE: The insider trading cases that we've cited in our briefs are instructive on this point, because in those cases, the US effects were attenuated. The sale or purchase of shares in the insider trading case only indirectly affects US investors.

For example, in the *Unifund* case, the defendant traded, on behalf of inside information, options of a company that was listed on the US stock exchange. Now, that activity created a near certainty that somewhere on the other side of those trades would be a US investor. Similarly, in --

THE COURT: So your jurisdiction is dependent upon not the sale itself, but his being involved in a sale which would have consequences, illegal consequences, for other investors?

MR. NEWVILLE: That's right, your Honor.

There's two different bases for personal jurisdiction. One is the investment in US company through US law firm under a US purchase agreement. And the second one is the sale of those shares, which would undoubtedly have effect somewhere along the line on US investors. For example, one of the cases that was cited by Dr. Carrillo's counsel is the *SEC v. Alexander* case. There, the Court exercised jurisdiction over a foreign

defendant who traded in a foreign account, US shares, and only dismissed the defendant where that person really didn't do anything whatsoever connected with the US or with the trading.

THE COURT: Well, that's what I'm trying to ask you. What's the difference between that and Dr. Carrillo? What did Dr. Carrillo do that had a relationship with the US?

MR. NEWVILLE: Right. And I think counsel for Dr. Carrillo has kind of gotten hung up on the fact that Dr. Carrillo granted his son trading authority over his account. We're not saying that he relinquished authority. The most --

THE COURT: But what is the evidence that you have that Dr. Carrillo is involved in this scheme? That's what I'm basically trying to understand. I got a guy who buys some stock in a company that his son is involved in. He sends him $10,000. Sends his son a power of attorney. The son buys the stock, in his account. The son at a particular time, when he's -- as you would argue, when he's benefiting from his own scheme, decides to sell the stock, and he sends Dr. Carrillo his money back to Mexico.

What is it that Dr. Carrillo did to be part of this scheme?

MR. NEWVILLE: In the complaint we allege that he sold the shares. And those shares were sold without the benefit of a registration statement, which serves to protect US investors,

and especially those investors who bore the end of that stock without that benefit.

THE COURT: Why is Dr. Carrillo culpable? That's what I'm not understanding.

MR. NEWVILLE: We don't have to prove his scienter for purposes of a Section 5 case. We don't have to prove --

THE COURT: But he wasn't the one that -- you don't even allege that he did the sale.

MR. NEWVILLE: Your Honor, we allege twice in the complaint that Dr. Carrillo sold the shares.

THE COURT: In what way are you alleging that he did the sale?

MR. NEWVILLE: The reasonable inference, when you've got an account that is in one person's name and somebody else has been granted power of attorney, is that both of them retain the ability to control the account.

THE COURT: Right.

MR. NEWVILLE: So a sale on that account is a sale by the account holder.

THE COURT: But it's not necessarily a sale by him in violation of the rule, if somebody else sells it for him. If I call up someone and say, "I want to buy some stock, I hear it's a good stock," and the guy says, "okay, I'm a broker, I'll buy it for you." I said, "well, hang on to it. When you think it's appropriate for me to have my money back, you have

discretion, sell the stock whenever you want to and just send me my money. All I want is a profit, okay," on what basis am I personally liable if it turns out those stocks aren't registered, simply as an owner of the stock?

MR. NEWVILLE: Because any sale that's made without the benefit of a registration statement is in violation of Section 5. If there is an exemption from registration --

THE COURT: Suppose I say that I didn't sell it. I didn't make the decision to sell it. It wasn't my decision. I gave somebody else the power of attorney over that stock. One, I didn't even know -- one, I didn't know the stock wasn't registered. Why am I supposed to know? I'm just, you know, a doctor in Mexico. I don't know anything about US registration. My son says it's a good stock out there. You've got a good investment. I say, "okay, fine, here's some money." He calls me up, says, "you know what, that stock you told me to buy, it went up in price. I sold it for you and I made you some money off it. I'm going to send you your money."

You're going to charge me with selling an unregistered security? Is that the way it works?

MR. NEWVILLE: Your Honor, it's a strict liability statute.

THE COURT: What I'm asking you, is that the theory on the way you say it worked, that simply because I owned the stock, if the person I gave the power of attorney to sold it,

that makes me liable?

MR. NEWVILLE: Your Honor, it sounds like it would be.

THE COURT: That's your theory? I'm asking.

MR. NEWVILLE: It sounds like it would be liable under those facts. Under these facts we've actually alleged he made the sale. We alleged that he sold shares.

THE COURT: You don't allege that he did anything -- you don't allege that he made the decision to sell the shares. You don't allege that he called up and gave direction to sell the shares. You don't say that he got on his computer and clicked the button that said "sell." You don't allege at all that he personally made the decision or personally sold the shares. You don't allege that.

You allege his son sold the shares. Am I wrong?

MR. NEWVILLE: No. We allege that his son gave some trading instructions on that account.

THE COURT: Well, what did he do?

MR. NEWVILLE: Dr. Carrillo controlled the account.

THE COURT: What did he do to sell the shares?

MR. NEWVILLE: Your Honor --

THE COURT: Is the answer nothing? I'm asking. This is not a trick question. What did he do to sell the shares? If you have a different theory, simply because he's the owner and he has the ability to make the decision, I'll hear that argument. But you say that you've alleged that he sold the

shares. I don't see anywhere where you've told me how he sold the shares.

In what way did he sell the shares, other than they were his shares, he owned them? Is there any other act that he took that sold the shares?

MR. NEWVILLE: We don't allege particular acts that he took to sell the shares.

THE COURT: So in what way are you alleging that he sold the shares; because he owned it? Is that why?

MR. NEWVILLE: Yes. He owned the shares.

THE COURT: Okay. Other than being the owner of the shares, you're not alleging that he decided to sell the shares; you're not alleging he gave any direction to anybody to sell the shares; you're not saying that he personally sold the shares; you're saying his son sold the shares, right?

MR. NEWVILLE: No, we're not saying -- your Honor, I'm sorry. We're not saying that his son sold the shares.

THE COURT: Who sold the shares?

MR. NEWVILLE: The shares were sold in an account in Dr. Carrillo's name.

THE COURT: Who sold the shares?

MR. NEWVILLE: Dr. Carrillo.

THE COURT: How did Dr. Carrillo sell the shares? Tell me what Dr. Carrillo did to sell the shares.

MR. NEWVILLE: That's the question we have for

Dr. Carrillo.

THE COURT: No. It's a question I have for you. You have to allege that he sold the shares. In what way are you saying he sold the shares? It's not a trick question. If he's just -- you're just sort of hiding behind the wall of saying he says it's his shares. He gave the power of attorney to somebody else. That's our theory. I'll understand that's your theory, and then I'll decide whether I think that's a valid theory.

MR. NEWVILLE: Yes, your Honor, that is our theory.

THE COURT: If that's your only theory, then don't tell me he sold the shares. Tell me that you're charging him with this violation because he is the owner of the shares that his son sold, and his son was given power of attorney, which included that power to sell those shares by the father.

But you're not -- there's no way that you're claiming that he did anything to initiate the sale of these shares, right?

MR. NEWVILLE: No, your Honor. We don't allege that in the complaint.

THE COURT: That's all I'm asking. So he didn't sell the shares personally; he didn't make the decision, or he didn't take the action to sell the shares, right?

MR. NEWVILLE: Well, frankly, we're not sure what the facts are going to show. But we are --

THE COURT: You're not alleging that, and you have no facts at this point for me to -- that's not what you're trying to make me believe from this complaint, right? If it was, I'm sure you would have said it. So you have no evidence at this point that he personally sold the shares, right?

MR. NEWVILLE: We don't have evidence either way, other than --

THE COURT: There's no such thing as evidence either way. You either have evidence that he sold the shares or you don't have evidence that he sold the shares. You have no evidence that he personally sold the shares, participated in the decision to sell the shares, gave direction to anybody else to sell the shares or personally took action that effectuated the sale of the shares; is that accurate?

MR. NEWVILLE: We have not alleged that in the complaint, your Honor.

THE COURT: Is that accurate?

MR. NEWVILLE: That is accurate.

THE COURT: So you say that he should be hauled into a US court from Mexico to defend this action because his son made a decision within the authority he gave him to sell the shares on his behalf; that's basically it?

MR. NEWVILLE: Unfortunately for Dr. Carrillo, the distinction of whoever made the decision to sell shares in his account does not make a difference.

THE COURT: So Dr. Carrillo is liable for the shares because the -- now, what is the basis on which -- am I supposed to imply from this that Carrillo knew this was happening, Dr. Carrillo knew this was happening? Is that what you're trying to imply or no?

MR. NEWVILLE: Unfortunately for Dr. Carrillo, his intent is irrelevant.

THE COURT: I'm not talking about intent. I'm talking about knowledge. No, you're not even talking about intent. You know what goes to intent. I'm asking you about knowledge. You're not even alleging that he knew this took place when it took place?

MR. NEWVILLE: We're not, your Honor, because it's a strict liability statute.

THE COURT: Strict liability for what?

MR. NEWVILLE: For the seller of shares.

THE COURT: Strict liability against whom; the seller of the shares or the owner of the shares?

MR. NEWVILLE: Against both.

THE COURT: Okay. All right. So if I have a broker, and I tell the broker, "buy me some stock, and I'm letting you control that account for me." He buys some stock. Turns out the stock is not registered. I live in South America. He sells the stock, sends it to me. You send me a notice from Washington that I should come up from Buenos Aires to defend

myself because the stock that my broker happened to buy turned out not to be registered. That's basically your theory?

MR. NEWVILLE: I believe that's correct, your Honor.

THE COURT: Okay. You know, you may be right. Sounds pretty harsh to me, but, you know, let's see if they want to dispute that. But okay. That's all I want to understand.

You don't accuse Dr. Carrillo -- and that's why I'm trying to understand from both the jurisdictional basis and a liability basis, you do not claim that Dr. Carrillo came to the United States to be involved in any of this activity; that he directed any of this activity; that he participated in the decisions about any of this activity; that he was even aware that any of this activity was taking place. But you say that because he has an account in the United States in which unregistered securities were sold, you have a basis to assert jurisdiction over him?

MR. NEWVILLE: No. The account where the shares were dumped was an account that was opened in Canada.

THE COURT: I'm not sure -- sorry. I missed your point.

MR. NEWVILLE: The bank account through which the purchase was made was an account in the US.

THE COURT: Right.

MR. NEWVILLE: The shares were dumped through an account in Canada.

THE COURT: I'm sorry. I'm not following. What do you mean, shares were dumped through an account in Canada?

MR. NEWVILLE: The shares were held in an account in Dr. Carrillo's name in Canada. That's where the sale took place.

THE COURT: Okay. So how does that give you jurisdiction over Carrillo based on the sale if the sale took place in Canada?

MR. NEWVILLE: Well, that's why I mentioned the insider trading cases, your Honor.

THE COURT: But he's not insider trading. That's why I'm genuinely just confused.

MR. NEWVILLE: The jurisdictional point is the same, because it's the same jurisdictional statute.

THE COURT: Yeah, but not if you're basing it on -- you can't be basing it on the sale if the sale took place in Canada. That doesn't give you jurisdiction in US, right?

MR. NEWVILLE: It's a sale of a US stock.

THE COURT: In Canada.

MR. NEWVILLE: Through a Canadian broker, and necessarily, there would be counterparties to that --

THE COURT: Not in the United States necessarily. Why is it necessarily counterparties to that in the US?

MR. NEWVILLE: Because it's --

THE COURT: Do you even know that that's true?

MR. NEWVILLE: It's --

THE COURT: Is that, in fact, the case, that a US counterparty bought those shares? You don't know that.

MR. NEWVILLE: It's an eventuality that's bound to occur when you sell shares on the over-the-counter market.

THE COURT: Wait a minute. If I'm a Mexican citizen selling shares in Canada, why is it bound to occur that some US buyer is going to get the share?

MR. NEWVILLE: Because they're being sold on an open market to a variety of broker dealers. This is not a privately negotiated sale with one particular person.

THE COURT: And is that a sole US broker dealership? A variety of people buy this in a variety of countries, right?

MR. NEWVILLE: That's right.

THE COURT: So what does that have to do with the US? If I own shares that I sell in Canada, why am I supposed to foresee -- why is it foreseeable that some US consequences take place? I'm not sure I understand the argument. Because I thought your argument was that it was the US purchase and sale of that that was the basis of your jurisdiction.

MR. NEWVILLE: There's two separate bases. And when you put them together --

THE COURT: Well, one basis -- was the purchase made in the US?

MR. NEWVILLE: Yes, your Honor.

THE COURT: Okay. But the sale was made in Canada.

MR. NEWVILLE: Right, with US effects.

THE COURT: What were the US effects?

MR. NEWVILLE: The counterparties to those sales would necessarily include American purchasers and Canadian purchasers.

THE COURT: Why? Do you know that to be the fact?

MR. NEWVILLE: We did not trace all the individual shares, your Honor.

THE COURT: How can you say it's necessarily going to include US counterparties?

MR. NEWVILLE: Let me just refer you to --

THE COURT: I'm not sure why you are saying that as opposed to Canadian counterparties.

MR. NEWVILLE: Your Honor, I would just like to refer you to the insider trading cases that we've cited in our brief. And in those cases the purchases and sales were made on foreign stock exchanges. And the only link to the US there was the fact that the underlying security had a derivative that was linked to a US stock.

THE COURT: Yeah, but that's an insider trading case. This isn't an insider trading case. As you say, you don't have to prove scienter. You don't have to prove intent. You don't even have to prove any consequences, right? You don't have to even prove that anybody got suffered as a result of this sale

of unregistered shares, do you?

MR. NEWVILLE: No, we don't have to prove those elements.

THE COURT: Right. So what has that got to do with somebody is going to be hurt; there's some US citizen who's probably buying these stocks in Canada who's going to suffer because they sold or be affected because they sold it in Canada? I don't understand what that has to do with it.

MR. NEWVILLE: Because it provides the minimum context to exercise personal jurisdiction over the seller.

THE COURT: But you said that a person who sells stock in Canada should expect that he has -- there's minimal contacts to sue him in New York if the SEC decides that the shares that were sold in Canada were unregistered in the US?

MR. NEWVILLE: Yes, your Honor. I think I would agree with you there. And the point is the jurisdiction is based on the nation as a whole.

THE COURT: Right.

MR. NEWVILLE: And one point as to --

THE COURT: That doesn't include Canada. That's a different nation.

MR. NEWVILLE: Right.

THE COURT: I understand you say -- because that's where I thought you had a stronger position; that, you know, oh, they sold it and he had an account in the US, he bought it

in the US account and he sold it out of the US account to US citizens. I thought that was your argument. That's not your argument.

MR. NEWVILLE: No. The argument is that he sold the shares of the US company.

And another point that I want to make here is that for purposes of Section 5, this is not like a diversity case, where we can replead it in another jurisdiction. There is no other jurisdiction because it's the US federal securities laws.

THE COURT: Right.

MR. NEWVILLE: So to the extent --

THE COURT: So he violated US federal securities laws when he sold unregistered securities in Canada?

MR. NEWVILLE: That's right, your Honor.

THE COURT: I thought the sale had to be a sale of the US shares in the US.

MR. NEWVILLE: No. I don't think there's a requirement that the shares be sold in the US. That's why I keep going back to the insider trading cases, where all of the trading took place outside of the United States. And there's only a very minimal extenuated effect on US shareholders. Here, we've got somebody that invested in and became a shareholder of a US company directly.

THE COURT: Okay.

MR. NEWVILLE: And then the sales took place outside

of the US. We think --

THE COURT: Why does that make him liable, rather than a victim?

MR. NEWVILLE: Because unfortunately, for purposes of Section 5 liability, that statute is to protect all the other purchasers of those shares that purchase without the benefits of the registration statement.

THE COURT: Isn't he a purchaser of the shares?

MR. NEWVILLE: Right. He purchased --

THE COURT: He's not entitled to that benefit himself, if he didn't know that the shares were unregistered when he bought them?

MR. NEWVILLE: Right. His intent is irrelevant, your Honor.

THE COURT: It's not his intent. You say that the rule is to protect purchasers from unregistered shares. That's what he is, right? The purchaser of an unregistered share.

MR. NEWVILLE: He is, your Honor. And so were the Kirks.

THE COURT: Same category.

MR. NEWVILLE: And so was Dylan Boyle and all of the other purchasers that purchased under this same agreement.

THE COURT: All right. I think I understand your theory. It's not -- I mean, I'd have to look a little more carefully. It's not particularly compelling on its equities,

you know? You just say -- your response is, ah, tough luck on him. Strict liability, it was his. He's in the suit with everybody else. I mean, he didn't do anything wrong, but, who cares? We're going to sue him anyway.

That's basically your argument, right?

MR. NEWVILLE: Let me just add that --

THE COURT: Do you think he did anything wrong?

MR. NEWVILLE: I do.

THE COURT: Personally?

MR. NEWVILLE: I do.

THE COURT: Do you have evidence that he did something wrong, consciously did something wrong?

MR. NEWVILLE: I'm not at liberty to start disclosing facts that we don't have in the complaint. And I don't think it's relevant for purposes of --

THE COURT: That's fine. That's fine. You're right, it's not in the complaint, so I'm going to assume it doesn't exist; because that's what I assume exists, is what's in the complaint.

So you say that the only facts that I have is that he's in Mexico -- how do you claim that he purchased the shares? Do you claim that --

MR. NEWVILLE: By providing $20,000 to the attorney trust account that was located in California at his son's law firm.

THE COURT: I know. But when -- he gave that money for what purpose?

MR. NEWVILLE: To purchase shares of Pacific Blue.

THE COURT: That was his intent when he gave the money?

MR. NEWVILLE: Right. And we allege paragraph 145, quote, Dr. Carrillo acquired Pacific Blue securities as part of this transaction from an issuer or an affiliate of the issuer with a view to public distribution.

THE COURT: And what you mean by that is the son Carrillo bought the shares for him; that's what you really mean, right?

MR. NEWVILLE: Right. That all the shares were purchased in trust by the Carrillo Huettel firm and then assigned to a bunch of nominee entities.

THE COURT: Right. Right. And what you are attempting to allege is that the son did that to facilitate this greater scheme?

MR. NEWVILLE: As to the son. That's what we allege.

THE COURT: Right.

MR. NEWVILLE: As to Dr. Carrillo, I think the allegation stands on its own.

THE COURT: Right. You don't claim that Dr. Carrillo did -- was participating in that or had any reason -- had this same reason or even was aware of the reason that these folks,

or aware of the Pacific Blue relationships, with the others and the -- other people's beneficial interests, and to try to tout -- aware of the pump and dump scheme; you're not accusing Dr. Carrillo of any of that?

MR. NEWVILLE: No, we're not accusing him of participating in the fraudulent scheme. We're accusing him of acquiring the shares with a view to distribution and selling them without registration, which is improper under the securities laws.

THE COURT: Okay. All right. Then I understand. I guess, unless you have some other argument or some other facts that you want to rely on in this complaint -- because the facts aren't particularly numerous with regard to his personal involvement, so I'm trying to understand your theory. Your theory is that being the beneficial -- being the owner of these shares, that when he sold them, that makes him strictly liable as a defendant in this case in the United States?

MR. NEWVILLE: Yes, your Honor.

THE COURT: Even though he's not in the United States?

MR. NEWVILLE: I think under the laws that apply to Section 5 liability, that's the law.

THE COURT: All right.

MR. BRODY: Your Honor, is there a different argument that you would like me to address now?

THE COURT: You know, I think the one that I want to

go to -- and then we'll take a break in about ten minutes. The one I want to go to is probably Gibraltar, because I understand your theory with regard to Gibraltar and the other case we discussed. So that probably can be quick with Gibraltar.

I'm trying to figure out what it is you say Gibraltar was involved in. Is Gibraltar's liability supposed to be strict liability also or -- I've got to go back.

MR. BRODY: Are you talking about the Section 5 claim, your Honor, or are you talking about the fraud claims?

THE COURT: Gibraltar is under the fraud claim, right?

MR. BRODY: And under Section 5 as well, your Honor.

THE COURT: Section 5 I understand, the unregistered securities. And that's a similar argument that we heard in the other case, so I don't really need a lot of argument on that. What I'm trying to figure out, what is it that you say Gibraltar -- let me -- I'll focus you on where I am having difficulty.

Gibraltar for a living decides that they will tout -- they will hold themselves out to be an entity that could buy stock for people who don't want to buy stock in their own name. They do that every day of the week, okay? They do that, and 99 percent of their clients are doing that without any evidence that they're committing any violations of criminal or civil laws by doing so. Okay? So I would expect that the Gibraltar would do in this case the exact same thing they would do in

every other case. And I'm trying to figure out what is the allegation you make against Gibraltar, as they say, that puts them in the suit of this scheme, other than they're just doing the same thing they did every day.

And I gave my law clerk this example. She thought it was good. I didn't think it was so good. This is the example I gave, and then we can talk about it briefly, and we can continue after lunch.

I'm a cab driver. I'm sitting in front of the bank. A guy walks in the bank, robs the bank. Comes out, hails the cab. Gets in the cab. I take him where he wants to go. Not everybody is accusing me of being the getaway driver for the guy who robbed the bank. I'm saying, look, this is just what I do. I'm a cab driver, I take people where I want to go. I didn't know the guy was robbing the bank.

So why isn't Gibraltar in that kind of situation? Gibraltar just says, look, I know, you know, it all looks a little funny. You know, people obviously got their own reasons. They may want to avoid taxes. They may want to avoid divorce judgments. They may want to not let people know what assets they have. But they want somebody else to front for them for buying shares. And we do that for a living. We do that for the good guys. We do that for the bad guys. We don't ask any questions. We just do it.

What is it about this incident that makes it a

knowledgable, intentional act to be involved in the scheme as opposed to the guy that did this the day before or the guy they did this for the day after? Do you understand my question?

MR. BRODY: I think I understand part of your question, your Honor.

THE COURT: What do you allege -- in what way did they participate in this scheme, other than to simply say, okay, you want to buy or sell stock? What we do for a living is that we do it for you and we say it's in our name. Now they may have us on another violation; maybe we shouldn't be doing that.

But what allegation in this complaint makes them a knowledgable intentional participant in the greater scheme?

MR. BRODY: First of all, your Honor, I would suggest that your analogy with the cab driver is not really appropriate, because in the instance with the cab driver, you have an innocent person who happens to be there; wrong place, wrong time.

THE COURT: That's what Gibraltar is claiming.

MR. BRODY: I don't think so, your Honor. Gibraltar is --

THE COURT: Sounds like a pump and dump scheme.

MR. BRODY: Gibraltar is an inherently corrupt organization that makes a living hiding people's identities. And the moment the SEC --

THE COURT: But that's not what you're charging them

with.

MR. BRODY: It is, your Honor, because we specifically state in our complaint that that is what Gibraltar does and that's how Gibraltar makes a living.

THE COURT: I know, but that doesn't make them liable of the particular pump and dump scheme that you want to put them in. Give me an example in this complaint that I can infer that they got involved in this with knowledge or intent to further the pump and dump scheme. Give me one example.

MR. BRODY: Setting aside the scheme for one second, your Honor, they made specific false representations to Scottsdale because they --

THE COURT: They make those specific false representations every day.

MR. BRODY: And every day those specific false representations is a violation of the securities laws.

THE COURT: Right.

MR. BRODY: Every single --

THE COURT: That's not a pump and dump scheme.

MR. BRODY: Doesn't make a difference, your Honor, whether it's a part of a pump and dump scheme or not. It's a false representation. They're telling Scottsdale that the beneficial owners of these shares are these entities. And the truth of the matter is that Gibraltar knows very well that these entities are not the beneficial owners, if the beneficial

owners of the stock are -- is Kirk.

THE COURT: You see, that's different. That's different. That doesn't put them in a pump and dump scheme. It doesn't put them in any fraudulent scheme to fraudulently take money from people or to defraud people. That doesn't mean -- why does it follow that somebody is going to be defrauded by that representation? The only fraud that you contend in this case is a fraud to -- for those people who were pumping up the stock, not to let the others know that they were going to be the beneficial owner of this false value in the stock. And that's the scheme that you want to put Gibraltar in. That's the scheme that you've put Gibraltar in.

So what is the allegation that Gibraltar knew or participated in or in any way had a relationship with the scheme to falsely tout a stock by saying that they're an independent researcher and not disclosing that the people who were touting that stock were not independent but were, in fact, involved in a pump and dump scheme to push up the price so they could sell it? You don't even say Gibraltar knew that that was occurring.

MR. BRODY: That's correct, your Honor.

THE COURT: So you're not accusing them of that?

MR. BRODY: We don't accuse Gibraltar of having specific knowledge of the pump and dump scheme that was taking place with Skymark and Emerging Stock. You're correct.

THE COURT: But isn't that the scheme that you're alleging in Count One of the indictment?

MR. BRODY: I'll say two points, your Honor, which is that we're holding Gibraltar liable under both misrepresentation theory of liability and under scheme theory of liability, your Honor. Under the misrepresentation theory of liability, it doesn't make a difference if they knew about the scheme.

THE COURT: What's the misrepresentation theory of liability, because --

MR. BRODY: Because they're handing Scottsdale a false --

THE COURT: You didn't understand my question. Which count is the theory, is that theory? Because both Counts One and Two say that they employed devices, schemes and artifices to defraud. They're both scheme counts.

Which is the nonscheme count? That's what I don't understand.

MR. BRODY: Well, your Honor, with respect to the second claim for relief, your Honor, we bring the claim based on A, B and C. B is not the scheme liability theory, your Honor. B is the misrepresentation theory of liability, your Honor.

THE COURT: Well, where --

MR. BRODY: They made untrue statements of material

fact.

THE COURT: So --

MR. BRODY: So we're alleging, your Honor, both misrepresentation theory, as well as scheme theory, your Honor.

THE COURT: Well, then tell me what is the scheme theory?

MR. BRODY: Well, the scheme theory, your Honor, is that they are part of a participant in helping the owners, the beneficial owners of this stock, hide the fact that they are the beneficial owners.

THE COURT: But that's not --

MR. BRODY: And the fact that they don't know about the rest of it is irrelevant.

THE COURT: But that's not the scheme that you're accusing the others of. You're accusing the others of a much broader scheme.

MR. BRODY: And you're right, your Honor --

THE COURT: So you can't put them in the same count, because that's a different scheme.

MR. BRODY: Not everyone, your Honor, has to have the equivalent knowledge of the scheme to be part of the same scheme. There are different components of the scheme that are taking place.

So, for example, Gibraltar's involved in one aspect of it. They may be blind to the rest of that aspect, but they're

still involved in that overall scheme, even if they don't have knowledge of the other parts, your Honor. The knowledge they have is a knowledge that what they're doing is incorrect.

THE COURT: Tell me how -- I'm not quite sure what -- you're saying that that's true simply because they misrepresented a beneficial ownership?

MR. BRODY: That's correct.

THE COURT: But that in and of itself -- would you agree that simply misrepresenting the beneficial ownership of the shares is not sufficient under A to employ a device, scheme and artifice to defraud? That alone does not make it under A. Would you agree with that?

MR. BRODY: No, your Honor. I think that the misrepresentations that are -- in the context of the overall scheme, the fact that even though their acts are limited to the false representations, that doesn't make their liability under the scheme liability theory less, your Honor.

THE COURT: Tell me what their intent to defraud was.

MR. BRODY: Your Honor, if you have knowledge in your possession that is contrary to what you are saying, that is recklessness. That is the intent to defraud.

THE COURT: No, that does not necessarily turn into an intent to defraud the investor. I can tell the investor that the product is made is blue and not red. And it doesn't mean just because I know it's -- that's not true, it doesn't mean

I'm defrauding the investor. That's what scienter is about, isn't it?

MR. BRODY: No, your Honor. Scienter -- first of all, the misrepresentation doesn't have to be made to an investor, your Honor.

THE COURT: But the misrepresentation has to be made to defraud, right? There has to be an intent to defraud.

MR. BRODY: We don't have to allege in the complaint that I decide -- that I woke up in the morning and said I wanted to commit fraud. What we have to allege in our complaint in order to meet the scienter requirement is that I made a false statement and I knew that statement was false.

THE COURT: No. That's not true. That's not true at all.

MR. BRODY: Or reckless --

THE COURT: Wait a minute. Over lunch you show me a case that says simply because you prove that they made a material false statement and you don't prove that it was made for the purpose of defrauding someone, that that still meets the --

MR. BRODY: For purposes of intent and recklessness, your Honor?

THE COURT: For any purpose.

MR. BRODY: All I have to demonstrate is that they knew the statement they were making was false. It's a false

statement.

THE COURT: That's right. So if I didn't intend to defraud anybody, simply making a false misrepresentation you say violates the --

MR. BRODY: If I make a false representation --

THE COURT: That is not intended to defraud.

MR. BRODY: In connection with the sale and purchase of securities, that creates liability for me under the securities laws.

THE COURT: Yeah, but --

MR. BRODY: They made a false statement.

THE COURT: No.

MR. BRODY: They knew the statement was false.

THE COURT: That's not what I'm asking. I'm asking you whether or not you say that you're trying to now allege A, B and C, right? You're saying you try to allege all three sections. Don't two of those sections require an intent to defraud? Or maybe I have it wrong. Isn't that true?

MR. BRODY: No, I don't think that's true, your Honor.

THE COURT: So what does it mean for you to allege that they employed devices, schemes and artifice to defraud? You're saying that's not a requirement, that's just gratuitous language?

MR. BRODY: I don't think you have to show their specific intent to defraud.

THE COURT: But you have to show some intent to defraud, right?

MR. BRODY: I think you have to show that you knew what they were doing in connection with this overall scheme was not correct.

THE COURT: No. They have to have intent to defraud, right?

MR. BRODY: I don't think that's the intent we have to demonstrate, your Honor. I think the intent we have to demonstrate is the recklessness that what they were doing was, in fact, false and in connection with the purchase --

THE COURT: But suppose it was false and it wasn't going to affect the price of the shares. You're not going to say that that would affect --

MR. BRODY: Then it would be a different issue. Then materiality would be the issue.

But in this case materiality is not the question because they know that the reason why Scottsdale requires this information is because Scottsdale has to assure themselves that it is not acting as an underwriter. So the way Scottsdale --

THE COURT: So you're saying Scottsdale is being defrauded?

MR. BRODY: Sure.

THE COURT: You're not talking about the investor being defrauded?

MR. BRODY: We don't have to demonstrate the --

THE COURT: I'm asking. I'm asking --

MR. BRODY: Scottsdale is being defrauded, your Honor. And likewise, all of the people who purchase through Scottsdale are being --

THE COURT: The problem I have is I'm just trying to understand what your theory is. Who's supposed to be -- is anybody being defrauded? Who's being defrauded? You've thrown in about eight people into the same count, but you tell me that they had different schemes. You tell me that Carrillo, Huettel De Beer, Kirk, Hinton, Trade Show, Pacific, they were all scheming and planning to try to do a pump and dump scheme. That's the scheme that you lumped at me. You don't say Gibraltar was trying to do a pump and dump scheme, but you throw them into the same scheme. So you're saying even though they didn't know it was a pump and dump scheme, I can just throw them in because their scheme was limited to just giving false information to Scottsdale?

MR. BRODY: Yes, your Honor. They're --

THE COURT: That's the way you charge it.

MR. BRODY: Yes, your Honor.

THE COURT: So you don't --

MR. BRODY: With respect to the other defendants, it's true as well that not every defendant in this case did the exact same thing, even though they're a part of the same -- the

scheme, if you want to call it --

THE COURT: What is the scheme? What is the common scheme?

MR. BRODY: The scheme was the Kirks and Boyle selling their shares. They involved a lot of other people in different aspects of the --

THE COURT: What was the common illegal scheme? What was the common illegal scheme to defraud?

MR. BRODY: Was the sale of the unregistered shares.

THE COURT: But I thought it was the pump and dump scheme.

MR. BRODY: Well, but it was -- that's part of it.

THE COURT: Well, it can't be part of it. Those are two different things. If I decided my intent was and my purpose was and my activity was to simply sell unregistered shares, that doesn't put me in a scheme with other people who are doing a pump and dump scheme, right? Doesn't make me part of that same scheme. You can't charge me with them and say, well, you had that part of their scheme. That's why -- you can't put that -- you can't put them in the same scheme.

MR. BRODY: Their role was more limited, but they were an essential element of that scheme. But for them, the sale of the shares couldn't have been sold.

THE COURT: And you're saying that that's true even though they had no knowledge; if they had no knowledge of the

scheme, and they had no intent to do anything to further a pump and dump scheme, they're still liable for the pump and dump scheme that you're charging the other --

MR. BRODY: Gibraltar is setting up numerous accounts, numerous accounts --

THE COURT: I understand.

MR. BRODY: Not being for the same person.

THE COURT: They do that every day, though.

MR. BRODY: There's no legitimate --

THE COURT: Wait a minute, then we're going to take a break.

They do that for the people doing pump and dump schemes, and they do that for the people not doing pump and dump schemes. The only way you can put them in with the people doing pump and dump schemes is if they're doing it to facilitate the pump and dump scheme. Doesn't that make sense?

MR. BRODY: I'll think about that over lunch.

THE COURT: Okay. Let's do that. I mean, that's what I'm trying to do. You know, I've got all these people lumped in these two schemes. You can't keep splicing it and say, well, but, you know, they were just trying to defraud Scottsdale. These people were trying to defraud the investors, and these people were involved in a pump and dump scheme, so we dumped them all into the same violation, because I don't know if we even have them under aiding and abetting.

MR. BRODY: Your Honor --

THE COURT: You even have them under aiding and abetting. You have them aiding and abetting --

MR. BRODY: For aiding and abetting, your Honor --

THE COURT: Ben Kirk's violation of 10(b). How can you -- you can't unknowingly aid and abet someone else's violation of the law.

MR. BRODY: You don't have to demonstrate for the knowledge purposes ever aiding and abetting. I don't believe, your Honor, that you have to establish the knowledge of what the exact person, the aider and abettor, are doing. You have to acknowledge that what he was doing was wrong. And I think they had knowledge what he was doing was wrong because he's setting up these multiple accounts, and he's hiding the fact that --

THE COURT: No. No. You can't aid and abet a violation of 10(b) unless that is your intent to help someone violate 10(b). So you can't say they're violating -- I'm helping them to violate something other than 10(b), and then charge them with an aiding and abetting of 10(b).

Do you understand what I'm saying?

MR. BRODY: I do. What I would suggest, your Honor, before we head to lunch is that regardless of how you view the scheme liability case, the scheme liability aspect, that they are also being charged with misrepresentation liability. And

the fact is that they made --

THE COURT: Not under that count.

MR. BRODY: Under count B, under the second count, they're being alleged as committing A, B and C. And B is misrepresentation, your Honor. And they made a false representation to Scottsdale that was clearly in connection with the purchase and sale of securities, because they're telling Scottsdale who the beneficial owner is, and they're not being truthful about that. And they understand that the reason why Scottsdale needs this information is so Scottsdale can assure themselves that it is not acting as an underwriter. So they --

THE COURT: You say everybody you charged under that count, that they're responsible for that?

MR. BRODY: I say everyone -- your Honor, each individual made their own -- not -- individual --

THE COURT: Because that's the way you charged.

MR. BRODY: Individuals made their own misrepresentations.

THE COURT: Yeah, but you don't charge it that way.

MR. BRODY: Those misrepresentations are contained within the text of the complaint before the charging document.

THE COURT: So you're --

MR. BRODY: So with respect to Gibraltar, we allege what their specific misrepresentations are.

With respect to the other defendants, we allege what their specific misrepresentations are.

THE COURT: You're not relying on the same representations, saying those representations had anything to do with the other?

MR. BRODY: I'm saying that Gibraltar's liable for its own misrepresentations and --

THE COURT: Well, you don't charge them separately as being liable for --

MR. BRODY: We don't break out each individual and say, in Count One we're going to charge Gibraltar for this and Count Two we're going to charge Carrillo for this and Count Three we're going to charge Huettel for this. Each one of them made their own misrepresentations. Carrillo made --

THE COURT: Slow down.

MR. BRODY: Carrillo made his misrepresentations. Gibraltar made their misrepresentations.

THE COURT: I think I understand better, if not just differently, your theory of liability, because that's not the way I read your complaint.

The way I read the complaint, in the standard way of reading a complaint, is all of those people who are charged under the same count are charged with the same act, okay? That's usually the way it's played. You don't charge both of us with bank robbery under one count and then say you robbed

Chase Bank on Monday and I robbed Capital Bank on Tuesday. That's not the way you do it. You've charged them all in one count.

And then you still beg the question of, what does the aiding and abetting mean? What is Gibraltar -- that you can't get around, because you're saying Gibraltar is aiding and abetting their violation. So you've got to give me some recklessness, some knowledge, some intent to further their scheme. But that's not the way you say you charged them. You're charging them with their own separate misrepresentations to Scottsdale. So --

MR. BRODY: I think we said we were charging them with both, the participation in the scheme and with the misrepresentations.

With respect to the scheme, it's our view that we don't have to allege they were participants in the entire part of the scheme, only that they were participants in their small part of the scheme.

THE COURT: But you have to tell me how they knowingly assisted the scheme, knowing the general purpose of the scheme. That's the law.

MR. BRODY: For the aiding and abetting claim or the primary claim?

THE COURT: For the aiding and abetting claim, you said they're aiding and abetting a 10(b) violation. You're not

saying they're aiding and abetting an unregistered security or misrepresentation about beneficial ownership securities. You say they're aided and abetted a 10(b) -- a fraud violation. They can't unconsciously aid and abet a fraud violation, wouldn't you agree? You would agree with that, right?

MR. BRODY: I think under your theory, I just think that our understanding of what knowledge is required may be a little different, your Honor.

THE COURT: Well, I don't even know if we've gotten there, because I'm not even sure what knowledge you assert. That's why I'm still at the point trying to ask you, what knowledge are you asserting on behalf of Gibraltar about a securities fraud violation? That's where I was. That's where I start. I still don't understand what you say Gibraltar -- how Gibraltar intended to help them commit a 10(b) violation.

So let's take the lunch break. As a matter of fact, let's come back at 2:30 and we'll continue.

(Luncheon adjournment)

AFTERNOON SESSION

3:34 p.m.

THE COURT: Okay. Yes.

MR. BRODY: Thank you, your Honor.

First of all, to the extent that your Honor pointed out that in a typical case you might expect to see a complaint that set forth separately the allegations or the claim that there's a misrepresentation case and a claim that there's a scheme case, we apologize for that, your Honor.

THE COURT: You don't have to apologize.

MR. BRODY: We note that in our opposition to the motion to dismiss on page 65, we specifically pointed out with respect to Gibraltar that we were asserting both a misrepresentation case as well as a scheme liability case. And just so the Court is clear on this --

THE COURT: That the misrepresentation case is based on both 10(b)(5)(B) and 17(a)(2). The scheme liability case -- scheme liability is 17(a)(1) and 17(a)(3) and 10(b)(5)(A) and C.

With respect to the 17(a)(2) claim, that's actually a negligence based claim as opposed to a fraud based claim. And I don't know to the extent that the Court finds that important, but it does have an impact on what we were discussing before your Honor, which is what is the knowledge that we allege in the complaint? And I think about Gibraltar's knowledge of the

larger scheme.

THE COURT: Right.

MR. BRODY: And I think the way we put it in our memorandum of law, this is the best way I think that we can put it is that the complaint alleges red flags sufficient to warn Gibraltar that a pump and dump scheme was taking place, including that it was selling large blocks of low priced, thinly traded issuers through multiple nominee accounts at Gibraltar that had been established to conceal Mr. Kirk's ownership.

And furthermore, we allege that Gibraltar was particularly positioned to understand those signs, given its business model, which we allege in the complaint. So --

THE COURT: But how is that different than any other security that they take and sell as --

MR. BRODY: Well, I don't know what other securities they sell. All I know is with respect to the securities at issue in this case --

THE COURT: So that should have been an indication of them of what, of what kind of illegality?

MR. BRODY: Well, your Honor, if someone had opened an account at Gibraltar and the stocks that went into those accounts were IBM and Microsoft and something along those lines, I think that Gibraltar could well assure itself that there wasn't a pump and dump going on because it's difficult,

if not impossible, to do pump and dump with those stocks.

But with respect to the type of thinly traded issuers that we're talking about here, Trade Show and Pacific Blue, these are stocks that are easily subject to a pump and dump.

THE COURT: That may be true, but why would you assume that the party that's asking you to sell it for them is involved in a pump and dump scheme as opposed to any other scheme?

MR. BRODY: You're right. There could be other schemes, I suppose, that are involved in there.

THE COURT: What points it to a pump and dump scheme?

MR. BRODY: Well, the multiple nominee accounts is also unusual, your Honor. If they had opened up one nominee account, then you could say, okay, there are potentially legitimate reasons for opening one nominee account.

The opening of three nominee accounts seems a little more unusual, your Honor, and would suggest that there is something going on in order to try to hide percentages of stock, which would suggest a pump and dump scheme; because the reason why you split up percentages, your Honor, is so you avoid disclosure requirements, which obviously are important in the pump and dump.

THE COURT: Well, the point -- for a lot of other reasons, also.

MR. BRODY: That might be --

THE COURT: But you're saying they were on notice that this was probably a pump and dump scheme, is that your theory?

MR. BRODY: Certainly on notice enough that they should have done further investigation before engaging in the type of activity they were engaging in. For example, sending those false letters to Scottsdale.

THE COURT: Yeah, but there's no such thing as negligently not looking at the red flags to find out whether I am a participant in a pump and dump scheme. I mean, I don't understand that theory.

MR. BRODY: I might disagree with your Honor on negligence versus reckless. I think that they were reckless as opposed to negligent. But even with respect to negligence, the 17(a)(2) standard is a negligence standard, your Honor. And 17(a)(3), your Honor -- sorry, which is the scheme liability statute under Section 17, or one of them at least, is a negligence standard, your Honor.

THE COURT: Okay. I mean, I think I understand what you're saying, but that's not what I get from reading the count. That's not what it said.

MR. BRODY: Well, and I understand that, your Honor. And that's what I was trying to say at the beginning, which is that the activities that they conducted are -- described throughout the bulk of the complaint, not just in the counts -- the counts make references to the various statutes that are at

issue, which aren't just scheme liability statutes. They're also misrepresentation statutes.

THE COURT: But that was going to be my second point. Even when I look through the rest of the complaint, I don't see that allegation with regard to Gibraltar.

MR. BRODY: They that they made misrepresentations or --

THE COURT: That's the only allegation that they made misrepresentations. But I see nothing else beyond that, nothing of what you just argued.

MR. BRODY: Well, I think right from the beginning, your Honor, with respect to how they're positioned, we argue about what the nature of the business was, of their business was. We argue -- I believe the complaint alleges that Pacific Blue and Trade Show were thinly traded securities. They were petty stocks, your Honor. So those allegations are there. The multiple nominee accounts, that's there. So the different pieces are in there.

The way that we described it in our memorandum of law puts that all together to describe the red flags that they were aware of or should have been aware of.

THE COURT: I understand, because I'm looking back at paragraph 140, 141, 142. I assume that those are some of the paragraphs that you're referring to?

MR. BRODY: Yes, your Honor. 141 specifically

describes that.

THE COURT: And am I correct in reading it that Gibraltar is accused of being involved in one sale, and that would be with regard to Trade Show shares only?

MR. BRODY: Hold on, your Honor. I believe it's both, your Honor, but I would have to read through the complaint, too, to look at that.

THE COURT: But I thought Gibraltar's role was only to trade Ben Kirk's shares in Trade Show, am I right?

MR. BRODY: Your Honor, I --

THE COURT: They did Ben Kirk's shares, right?

MR. BRODY: Yes. Ben Kirk was the only one who had the accounts at Gibraltar.

THE COURT: And did they trade something on behalf of Ben Kirk other than Trade Show shares?

MR. BRODY: Well, I thought Pacific Blue as well, your Honor.

THE COURT: There was --

MR. BRODY: I have to go back and look at the complaint, your Honor.

THE COURT: Oh, okay. All right. I think there is -- yeah, Pacific Blue and Trade Show. Okay.

MR. BRODY: The mechanism where it worked, your Honor, is that there were numerous -- there were three, I think, at least three nominee accounts at Gibraltar. And then those

nominee accounts would then trade through omnibus accounts that were held at Scottsdale.

THE COURT: I mean, I don't think this is determinative, but I find curious, why is Gibraltar charged and Davis is not? Why is Davis only charged with the sale of unregistered security? I was just curious why Davis is not in the Gibraltar account. Is there some reason for that?

MR. BRODY: Hold on, your Honor. It's been a while since I thought about that one.

Standing here, your Honor, I don't recall the reason why.

THE COURT: Because I only have Davis in the sale of unregistered securities count.

MR. BRODY: I believe that's right, your Honor.

THE COURT: And not the 17(a) count or not the 10(b) count and not the aiding and abetting violation.

MR. BRODY: That's correct, your Honor.

THE COURT: But you attribute all of Gibraltar's conduct to Davis or no? Are you saying there are others beyond Davis?

MR. BRODY: Gibraltar was the one, your Honor -- sorry. Davis was the one, I believe, who sent the representations to Scottsdale.

THE COURT: Right. That's what I thought. He was the one who made what you claim are the misrepresentations.

MR. BRODY: That's correct, your Honor.

THE COURT: But you're not charging him personally?

MR. BRODY: No, your Honor.

THE COURT: Okay. All right. Go ahead.

MR. BRODY: I don't know who your Honor wants me to address now.

THE COURT: You know, I think you can take all the others in any order you want, because I don't want you to be repetitive. So whichever way -- I think a lot of the arguments overlap with regard to the others.

MR. BRODY: I would agree with your Honor. I guess I'll try to address them in the order that they argued before your Honor. So I'll first address Luis Carrillo.

In *SEC v. Frank*, your Honor, the Second Circuit said that a lawyer no more than others cannot escape liability for fraud by closing his eyes to what he saw and could readily understand.

We heard a lot of argument from Mr. Carrillo's lawyer that somehow he was acting as a transactional lawyer and he shouldn't be held to some other standard because that -- or so he should be held to a lower standard; that there should be a higher threshold that the SEC should have to reach before they can make a case against him. We would suggest that that's not the case. But I think that that theme was echoed throughout Mr. Curran's entire presentation. So we would just have the

Court be aware of that.

He makes numerous arguments in support of his motion to dismiss, notwithstanding that he signed the attorney opinion letters at issue in this case. Carrillo argues that he is not the maker of the false statements in those letters, and in doing so he turns the Supreme Court's decision in *Janus* on its head.

In *Janus* the Supreme Court said that one makes a statement by stating it. Here, Carrillo and Huettel and their law firm made the statements. It's on their letterhead. Carrillo signed the documents and they sent the letters to Scottsdale and DTC. So recognizing this weakness, Carrillo argues that the ultimate authority for these opinion letters rested with someone else. And as this Court stated during oral argument -- I think it was spot on -- the Court said, how can I make that determination on the face of the complaint? On a motion to dismiss, where we are right now, when the facts alleged in the complaint are taken as true and all reasonable inferences are decided in plaintiff's favor, the Court cannot address this argument that somehow others had ultimate authority over the letters.

Indeed, in *Janus* the Supreme Court held then the ordinary case attribution within the statement or implicit from surrounding circumstances is strong evidence that a statement was made by the party to whom it is attributed. Here, the

attribution in the opinion letter is within the statement itself. Within the statement itself, it is the signature of Carrillo and the name of his law firm that appears in the letter.

Likewise, the Court in *Janus* held that the maker of the statement is the person with ultimate authority over the statement, including its content. Here, there is no argument by Carrillo that anyone but he and Mr. Huettel and the law firm controlled the content of the letter. Their argument appears to be that the Kirks and Boyle controlled when and to whom the letters were sent. But even with respect to that, the complaint says nothing about the Kirks and Boyle controlling the timing or the destination of the letters. To the contrary, the complaint in paragraphs 129 to 131 specifically provides that Carrillo Huettel provided the letters to Scottsdale and DTC.

In *SEC v. Boyd*, which is a 2012 case in the District of Colorado, the Court held that unless the client is actually controlling the actual contents of the letter, the attorney is the maker of that statement. And we note there are no allegations in the complaint that the Kirks and Boyle control the contents of these letters. Indeed, if the Kirks and Boyle dictated the contents of the attorney opinion letter to Carrillo, and Carrillo simply signed that letter, then it really wouldn't be an attorney opinion letter at all. And

Carrillo would have committed a wholly different kind of fraud.

Mr. Carrillo cites the decision in *SEC v. Garber* for the proposition that the client is the maker of statements in an attorney opinion letter to the exclusion of the attorneys. And this was not a holding in Garber. In that case the Court did not hold that the attorneys were not makers of the statements in the opinion letter.

The reverse situation was being argued, i.e. whether the person who had engaged the attorney to write the letter could be considered a maker, notwithstanding that the letter had not been attributed to him. In *Garber* the Court held that where the client had control over how the document was used, that client couldn't argue that it didn't have ultimate authority. But the Court in that case did not rule that the attorney was also not a maker of the statement. Indeed, that issue does not appear to have been before the Court.

In addition to the cases cited in our brief, we're going to refer the Court to the decision of the Court in *Kerr v. Exobox*, which is a 2012 decision from the Southern District of Texas, where the Court stated the obvious point, that the fact that a document is called an attorney opinion letter indicates that it is the statement of the attorney.

Likewise, in *SEC v. Greenstone Holdings*, after discussing the *Janus* "maker" requirement, the Court granted summary judgment against the general counsel of a company for

sending out false opinion letters without even a discussion of whether or not the general counsel was the maker, because of course he was the maker. The statements were specifically attributed to him.

Carrillo argues secondarily that because this is an opinion letter, the SEC has to prove that the statements therein were subjectively believed to be false, and Mr. Carrillo is wrong on this point. The mere fact that this document is titled an opinion letter does not mean that everything within that letter is a statement of opinion.

For example, the statement that the shares were fully registered is not a statement of opinion; it's a statement of fact. Likewise, the statement that the nominee entity was not an affiliate of Pacific Blue is not a statement of opinion. It's a statement of fact. These are not issues that are inherently subjective.

In the OSG securities litigation case cited in our brief, the Court rejected an auditor's argument that because the false statements were in an auditor's opinion letter, the standard was subjective falsehood. The Court stated that auditors cannot shield themselves from liability merely by using the word opinion as a disclaimer. And the Court stated that although the internal revenue code is complex, and often gives rise to debate, it cannot be said that statements of income tax liability are subjective valuations. Likewise, the

issue of whether stocks are free trading or restricted is objective. It's guided by rules but it's objective.

But even if the standard here was subjective falsehood, the SEC has met that required standard because the SEC has alleged at that time that Carrillo knew that the statements were false. As described in the complaint, Carrillo knew that the Kirks control Pacific Blue because he knew that Kirk paid 90 percent of the purchase price. And he and his firm designed the transaction that concealed the group ownership and control over the Pacific Blue shell by distributing shares in 4.9 percent increments. Carrillo says, and he argues, that he was entitled to rely on the statements of his clients that none of these foreign entities were controlled by them, no matter how unreasonable those statements might have been.

And Carrillo argues that through this case the SEC is telling transaction lawyers that they have to investigate their clients and that the securities laws should not be adjusted to make this requirement. The law, however, already requires attorneys to make such inquiries. In *SEC v. Spectrum*, which is a Second Circuit decision, the Court of Appeals stated that the securities laws provide a myriad of safeguards designed to protect the interests of the investing public. Effective implementation of those safeguards, however, depends in large measure on the members of the bar who serve in advisory

capacity to those engaged in securities transactions. And the Court held that in the distribution of unregistered securities, the preparation of an opinion letter is too essential, and the reliance of the public is too high to permit due diligence to be cast aside in the name of convenience. This is exactly what happened here even, if you credit Carrillo.

In *SEC v. Greenstone*, the Court likewise rejected the very argument raised by Carrillo stating that an opinion must have a reasonable basis. And there can be no reasonable basis for an opinion without a reasonable investigation into the facts underlying the opinion. The defendant implicitly represents by citing the opinion letter that he has conducted a reasonably sufficient examination of material legal and factual sources and had reasonable certainty as to the subjects addressed therein.

Your Honor, even if you credit Mr. Carrillo's arguments, there is no way that he did a reasonable investigation in this case. And indeed, his lawyer does not suggest that he did. His lawyer suggests that he was entitled to rely on the representations of his clients. And that is simply not the law.

Consequently, the SEC has sufficiently stated a case, a misrepresentation case against Carrillo based upon the opinion letters that were sent. The SEC has also sufficiently alleged that Carrillo participated in the scheme to defraud.

Carrillo has argued that he did not perform any deceptive acts, but this is false. The use of the attorney trust fund here was inherently deceptive. As your Honor stated, what would be the legitimate purpose for using the Carrillo Huettel trust account for the clients' transaction? That's not appropriate.

And when Mr. Curran responded to your Honor that if a client wanted to use his firm's trust account in that manner, that he would have an uncomfortable conversation with the managing partner of his firm, your Honor responded that that was because there would be no legitimate purpose for that kind of activity. The Court is right. This was an inherently deceptive act.

But the use of the trust account was not Carrillo's only inherently deceptive act. He drafted fraudulent nonaffiliate and affiliate share purchase agreements and arranged to distribute Pacific Blue shares in 4.9 increments to nominee entities, the purpose of all of which was to give the misleading impression that the shares were held by various independent entities. And the affiliate stock purchase agreement that he drafted for De Beer was particularly odious, since he knew that De Beer did not pay $80,000 for the 40 percent interest in the company. He knew that that money came from Kirk because the money came in through his attorney trust account. Carrillo drafted corporate filings for the company that he knew were false. He instructed Franklin to

sign a false related party worksheet that was to be relied upon by the auditors. Carrillo's counsel says that in order for these acts to be deceptive, the SEC would have to allege that Carrillo knew about the Kirks' control over the company, and he argues that the SEC has failed to make such allegations under Rule 9(b).

He repeatedly argued that the SEC has to allege knowledge with specificity. And this is an absolute misstatement of what is required under 9(b). 9(b) explicitly provides that unlike other aspects of fraud, state of mind can be alleged generally. As the Second Circuit stated in the Shields v. Cititrust decision, and as is repeated in numerous district court decisions, Rule 9(b) actually represents a relaxation of the specificity requirement in pleading the scienter element of fraud claims. And while fraud cannot be alleged based upon speculation and conclusory allegations, under Rule 9(b), allegations of scienter are sufficient if there exists a minimum factual basis giving rise to a strong inference of fraudulent intent.

Here, the SEC has given much more than a minimum factual basis to support Carrillo's knowledge of the Kirks' ownership and control. Carrillo knew that Ben Kirk purchased the Pacific Blue shell. As alleged in the complaint, Kirk paid 90 percent of the shell. And Carrillo facilitated the purchase of the shell through the trust account. As your Honor stated

at oral argument, if the money is coming through the attorney trust account, how can you possibly argue that he did not know where the money is coming from or whose money it was?

Moreover, the remainder was paid for by Carrillo's father. This is a further allegation that supports the inference that Carrillo knew exactly whose money was involved in this transaction.

The complaint further alleges that Carrillo Huettel were heavily involved in the communications between Pacific Blue and the Kirks, as they were participants in e-mails, that demonstrated that the Kirks were exercising control over Pacific Blue. As your Honor stated, unless there is some competing conflicting disputed evidence, a reasonable conclusion from a trier of fact, based on the facts alleged in the complaint, is that Carrillo knew that these were related parties and was a participant in a scheme to defraud.

Carrillo argues that his actions are just the actions of any transactional lawyer, but this is not true. Transactional lawyers don't fund money through their attorney trust account. Legitimate transactional lawyers don't structure ownership arrangements to give a false appearance. Legitimate transactional attorneys don't draft false statements for corporate filings or draft false statements to be provided to a company's auditors.

Finally, Carrillo argues that his deceptive acts have

to be entirely distinct from any misrepresentation made, but we note that in the *SEC v. Alternative Green* case, the Court rejected this very argument, finding that the creation of false corporate documents, as well as assurances to convince a transfer agent to remove the restrictions from stock certificates, those were inherently deceptive acts. This is the very case here and should come as no surprise that Carrillo does not address the *Alternative Green* case in his briefs.

If your Honor has any questions with respect to Carrillo, I'll answer them now. Otherwise, we'll move on.

THE COURT: Why don't you go to Huettel, since a lot of the arguments are the same but they make some factual distinctions.

MR. BRODY: Sure.

At oral argument Mr. Huettel argued that a reasonable inference that could be drawn from the complaint is that the Kirks represented a group of owners and that the Kirks were simply the face of this ownership group. Consequently, he argued that just because the money to purchase the Pacific Blue shell came from the Kirks does not mean that that money only belonged to the Kirks but, rather, a reasonable inference could be drawn that the money belonged to the group.

First, the complaint specifically alleges in paragraph 82 that Carrillo Huettel knew that these entities were nominees. And the complaint also alleges that the 4.9 percent

structure was specifically designed by Carrillo and Huettel to conceal and facilitate the manipulation, and the misleading impression that the shares were being held by various independent entities.

Moreover, the complaint alleges that the money was funneled through the trust account, which also demonstrates that there was an intent to mislead here because there's no legitimate reason for the money being transferred through the Carrillo Huettel trust account.

And lastly, any reasonable transactional attorney would have asked who controlled these mysterious foreign entities that purportedly were the purchasers of the shares. In the absence of that, how can Carrillo Huettel have honestly issued any of the opinion letters saying that these companies were not affiliates? How could they have honestly prepared any of the corporate filings, saying that there were no other entities, no other control entities? How could they have honestly prepared the schedule, frankly, that was provided to your Honor?

We think that the Court was absolutely right when it suggested to Huettel's attorney that the only reasonable inference that could be drawn from the allegations of the complaint is that Huettel knew that the Kirks controlled these entities.

In his memorandum of law, Huettel separately argues

that the SEC appears to have abandoned its claims against him based on false statements in favor of scheme liability. We disagree with that assertion in the memorandum of law, since the complaint alleges both theories and the SEC argued both theories in its opposition brief.

With respect to the misrepresentation, the SEC alleges that the law firm Carrillo Huettel issued numerous false opinion letters that Huettel worked with Carrillo to provide the opinions and that Huettel specifically drafted the March 2, 2010, DTC opinion. The fact that Huettel did not personally sign the opinion letter we do not believe is of any consequence, because the letters were sent by the law firm Carrillo Huettel. The letters describe "we" as the maker, not I, or the signatory Luis Carrillo. And because Huettel is only one of two named partners, and this was a very small law firm, we believe that the statements in the opinion letters are equally attributable to him as well as to Carrillo and the law firm generally.

And in the *Stillwater* case, which we cite in our brief, the Court held that a reasonable fact-finder could conclude that statements were made by all of the officers, given the small size of the company. We believe that that guidance is equally applicable here.

Moreover, in the *Pentagon* case the Court held that there could be more than one maker of a statement for *Janus*

purposes. Therefore, the SEC believes that has complied with *Janus* with respect to the statements alleged to be false that underlie the SEC's misrepresentation case.

THE COURT: But I want to make sure I understand how far you're pushing this. You're not saying that simply because he's the named partner in a small law firm, that if one of his other partners sends out a misleading letter, that there's some reasonable conclusion to reach that he participated in that?

MR. BRODY: If that was the only allegation in the complaint, I think it would be a tough case. But that's not the only allegation in the complaint, since Huettel here actually worked on the opinion letters as alleged in the complaint.

THE COURT: All right.

MR. BRODY: So I don't think we need to take it as far as potentially it could go, your Honor. But we think that we've complied with *Janus*.

I'm trying to cut through the arguments. I think with respect to scheme liability, I think we've already argued the existence of the scheme with respect to Mr. Carrillo. I'm not going to reargue it here.

But I want to address his aiding and abetting argument. Mr. Huettel argues he did not provide substantial assistance because the SEC merely alleges that he performed the typical tasks of a transactional attorney. Mr. Huettel,

however, does not cite a single case for the proposition that a lawyer who performs tasks in furtherance of a fraud cannot be held liable under aiding and abetting. Substantial assistance requires that the person associate himself with a venture, participate in it as something that he wished to bring about and sought by his actions to make it happen. And our allegations against him meet that standard.

Likewise, we allege that he had the requisite standard, with scienter, the knowledge. He knew that the share of Pacific Blue had been bought for and paid almost entirely by John Kirk. When he created documents, he drafted SEC filings that hid that fact he participated in e-mails demonstrating the Kirks were exercising control over Pacific Blue, and even provided Ben Kirk comments on Pacific Blue documents.

And lastly, I'll just address the argument of the Carrillo Huettel law firm, which was an independent argument that I guess is a policy argument where they say that they should be dismissed because the firm is defunct and that any liability that the firm would get would be duplicative of the relief that the SEC might obtain against the individual lawyers. As a preliminary matter, we believe that that argument is premature first outside of the representation of counsel and perhaps some articles that we've seen in papers. We have no confirmation that the law firm ceases to exist.

Second, we don't know what assets are available to pay

any judgment that the SEC might obtain in this case. We don't know what assets are in the names of Carillo and Carrillo individually and what other assets might be in the name of the law firm. The law firm might have assets that are available to pay judgments, and consequently, the firm should not be dismissed.

Fourth, we believe that there are important policy considerations in keeping the firm as a party to this action. As holding law firms responsible, we believe it sort of as a significant deterrent.

And finally, there isn't really an argument that the cost to the firm would be less if they're dismissed to this action. They still have documents. They'll still have to respond to discovery, whether or not they are a party or a third party. So we don't think that the costs would be measurably different. So for that reason, we don't believe that the law firm should be dismissed simply on the basis of its defunct status.

THE COURT: All right. Who do you --

MR. BRODY: I'll move on to Mr. De Beer.

Mr. De Beer was the president and CEO of Trade Show and the chairman of Pacific Blue. While serving as the president and CEO of Trade Show, he signed Trade Show's annual reports and quarterly reports. And the complaint alleges that these filings were misleading because they failed to mention

the Kirks and Boyle share ownership and the fact that the Kirks were control persons of Trade Show, as well as the fact that they were serving as de facto investment bankers, promoters and investor relation consultants.

Trade Show's public filings also misrepresented De Beer's compensation because they did not disclose over $330,000 in kickbacks that he received from the Kirks and Boyle. While serving as the chairman of Pacific Blue, De Beer signed Pacific Blue's form 10K, filed it in April 2010. This document was also falsely misleading because it failed to disclose the control and stock ownership and promotion by the Kirk group.

Mr. De Beer's main argument in support of his motion to dismiss is that the SEC has not properly alleged scienter. And at oral argument his counsel articulated the argument as follows: The complaint alleges that in June 2008 the Kirks gifted 10 million shares of Trade Show to various nominee accounts. Consequently, while De Beer concedes that he might have known in October 2007 when he first became the CEO and president of Trade Show that the Kirks controlled the company, after June 2008, when the share transfer took place, he had no reason to know that the Kirks continued to control the company. And he claims that the only basis alleged in the complaint for this knowledge is the fact that he possessed the shareholder records.

This argument totally misrepresents the allegations in the complaint. First, as we have stated previously, allegations of scienter are sufficient if there exists a minimum factual basis giving rise to a strong inference of fraudulent intent. And a strong inference can be alleged either by pleading motive and opportunity or strong circumstantial evidence of conscious misbehavior or recklessness. While either is sufficient in this case, the SEC has alleged both.

As described in paragraph 35 of the complaint, De Beer and the Kirks engage in an almost daily stream of communications regarding Trade Show press releases, business announcements and investor contacts. John Kirk drafted press releases for De Beer to release on behalf of Trade Show and also sent e-mails to De Beer, telling De Beer to release news and updated financials for the company. I think that the argument was made that the complaint doesn't specifically allege what the time frame of these communications were, but the time frame was the entire time of the complaint, and in particular, during the time of the promotion, because what are they releasing? They're releasing the press releases, the business announcements, the news and financial. This was part of the pump and dump scheme.

So during the time period following the transfer of the shares in June 2008, and in particular, during the time of

the pump, De Beer was getting communications from the Kirks demonstrating their control. Likewise, in paragraph 41, the complaint alleges that the Kirks, Boyle, Hinton and De Beer began promoting Trade Show in June and July of 2009. This activity also took place after the June 2008 transfer.

Most important, however, is the fact that in paragraphs 122 through 127 the complaint alleges that from July through September 2009, De Beer provided the Kirks and Boyle with corporate resolutions and certifications that allowed the Kirks around Boyle to deposit stock at Scottsdale for sale. As this Court pointed out, why would the Kirks and Boyle have even requested that De Beer provide these resolutions and certifications for the nominee entities if they weren't exercising control over the nominee entities?

And in September and October of 2009, shortly after De Beer provided those resolutions and certifications to the Kirks and Boyle, the Kirks and Boyle wired him over $330,000, the proceeds of the sale of the Trade Show stock. Again, as your Honor pointed out during oral argument, if the Kirks and Boyle did not control these nominee entities, why would they have sent De Beer proceeds from the sale of stock that those entities made? The only reasonable inference to be drawn from the various allegations of the complaint is that De Beer understood at all times that the Kirks and Boyle controlled the nominee entities and, therefore, controlled the company.

The facts are no better for De Beer concerning his involvement with Pacific Blue, because right from the very beginning, he knew that the ownership of the company was being misrepresented. De Beer received 40 percent of the company's shares pursuant to an affiliate stock purchase agreement. That agreement said that De Beer paid $80,000 for the shares, but De Beer knew that that was a false statement because he didn't pay any money for those shares. The money was paid by the Kirks and he was just to sign the shares.

Moreover, many of the nominee entities that purported to purchase 4.9 percent interest in Pacific Blue pursuant to the nonaffiliate stock purchase agreement were the very same entities that had been gifted shares of Trade Show in 2008, including Strotas, Irish Delta and Kita-Kaine. De Beer knew from Trade Show that those entities were controlled by the Kirks and Boyle. Consequently, he knew that the shares of those entities of Pacific Blue were likewise controlled by the Kirks and Boyle.

Finally, in paragraph 89, the complaint alleges that after the Kirks took control of Pacific Blue in September 2009, they asserted control over all of Pacific Blue's major decisions, including pushing the covenant draft of the press releases as giving what his position was in the company. De Beer had to know that the Kirks controlled. In sum, for both Pacific Blue and Trade Show, De Beer either knew that the

Kirks had control, Boyle controlled the nominee entities and, therefore, controlled the entities or was reckless with respect to that control. These facts are more than sufficient to meet the minimum factual basis standard.

Separately, the complaint alleges that De Beer had motive and opportunity. The motive comes from his receipt of $330,000 in kickbacks from the Kirks and Boyle, which was on top of the salary that he received. Mr. De Beer argues in his memorandum of law that 300,000, $330,000 is not an uncommon amount for CEOs to receive. According to De Beer, CEOs commonly receive seven-figure salaries. And perhaps if this was a real company, De Beer might have a better argument.

But as alleged in paragraph 46, this was not a real company. Trade Show's existence as a publicly traded company was solely to increase demand in the company shares so that the Kirks and Boyle could sell their shares. And as alleged in paragraph 66 of the complaint, for the fiscal year ended 2010, Trade Show's revenue was approximately $32,000, less than 10 percent of the kickback paid to De Beer. De Beer also argues that there are possible other plausible explanations for the payment, repayment of a debt, settlement of a dispute.

On a motion to dismiss, however, inferences are to be drawn in favor of the plaintiff. And the most plausible inference of the payments from the Kirks and Boyle, if not the only plausible inference, given the timing, is that this was a

kickback relating to the sale of shares. And, again, the key here and the elephant in the room is that the transfers from the Kirks and Boyle to De Beer were undisclosed. The fact they are undisclosed is demonstrative of the nefarious purpose. If there was nothing wrong with them, there would have been no problem disclosing it.

I'd like to move on to Mr. Hinton.

THE COURT: Yes.

MR. BRODY: Today during oral argument Mr. Hinton's counsel has suggested that there aren't allegations in the complaint that demonstrate that he did anything fraudulent. I'd like to address that.

The complaint alleges that Hinton set up the ESR boiler room. The complaint alleges that he was a director. The complaint alleges that he ran the day-to-day operations, and most important, it alleges that he ran the day-to-day operations from John Kirk's home. So I think the only inference that can be drawn is that Mr. Hinton knew that John Kirk was actively involved in Emerging Stock Report. That's what the complaint alleges.

The complaint also alleges that he owned shares, and that he also knew that the Kirks owned shares. And how does it allege that the Kirks owned shares? Because he was given proceeds from the Kirks' sale of their shares. He specifically alleged that in the complaint. So Kirk knows that ESR is being

run in part by John Kirk. He knows that John Kirk, or the Kirks for sure, but John Kirk owns shares of that stock. And he owned shares of that stock.

And then he engaged, he actually engaged in the promotions for the company. He promoted the company to multiple potential investors. He made calls to investors. And in these calls he didn't disclose his ownership of the stock and he didn't disclose the Kirks' ownership of the stock, and he didn't disclose that ESR was not independent.

Now, Mr. Hinton argues that the SEC has failed to allege a duty on his part. And we think the law is fairly clear, your Honor, where there are certain circumstances where a duty is created, even in the absence of some type of fiduciary relationship, one example would be insider trading. If I have material nonpublic information concerning a company, I'm not allowed to trade unless I make a disclosure, unless I disclose the information.

Likewise, with respect to scalping, if I am promoting a company, I am not allowed to sell shares of that company unless I disclose that I am selling my shares. The act of selling shares creates this duty, your Honor. So he had a duty. The duty that he had was to disclose that at the same time he's promoting the shares, that he is also a seller. And he never made that disclosure.

Mr. Hinton argues that the SEC has failed to prove

that he had scienter also based on the following argument, which is that he says the SEC has not alleged that he actually sold any stock. Consequently, the SEC cannot argue that he had motive and opportunity.

Moreover, citing a single 2005 case from the Southern District of Florida, Hinton argues that motive and opportunity alone is insufficient to prove scienter and that more is required. These arguments fail both factually and legally.

First, the SEC has alleged that Mr. Hinton sold stock. With respect to Pacific Blue, in paragraph 155, it says Hinton played a significant role in the Pacific Blue offering and served as a necessary participant and substantial factor in the distribution because he sold Pacific Blue shares that he received from John Kirk. So the allegation is clear that he sold the shares.

Likewise, in paragraph 160D and in paragraph 163D, the complaint alleges that Hinton realized proceeds of more than 21,000 and also received at least 31,000 in proceeds from sales from Ben Kirk controlled accounts. Now, I will concede to your Honor that perhaps this could have been drafted a little better. But the $21,000 that we're referring to here are the proceeds from his own sales as opposed to the $31,000 that he received in proceeds from the Ben Kirk controlled accounts. And the same thing is true with respect to Pacific Blue in paragraph 163D, where we say that Hinton also realized proceeds

of over 12,000 from shares sold during the pump and received an additional $150,000 in proceeds of Pacific Blue stock sales.

What we're trying to get across there, your Honor, was that the first part of that was his own stock sales. The second part of it, the $150,000, was money that he received from other persons' stock sales. But we made this very clear in our memorandum of law exactly what the meaning and understanding of this phrase was. So not only do we explicitly state that he sold shares; we also state in those two paragraphs how much money he earned from his own stock sales. Those stock sales, combined with his opportunity as a director of ESR, as well as the person who ran the day-to-day operations of ESR, that gives him the opportunity. The motive is the stock sale. Together, we think we've alleged scienter on that basis.

But Mr. Hinton is also wrong when he argues that motive and opportunity by itself is insufficient to prove scienter. In the Second Circuit, motive and opportunity alone is sufficient. And this is in the *Vaughan v. Powers* case, the Kolnet case, Novak case. These are all cited in our brief.

Finally, we allege that the very act of scalping, of promoting a stock while at the same time selling that stock into the market, is an inherently reckless act. Unless you disclose in the promotion that you are selling, you have committed an inherently reckless act. So the act of scalping

itself is an act of recklessness that meets the scienter requirement.

I'll move on to Ben Kirk. And then I think I've already addressed Gibraltar, your Honor, so I don't think I need to go through Gibraltar again.

Ben Kirk makes the following arguments. He says that because the complaint in certain paragraphs alleges that he and other people committed certain acts, he cannot ascertain from the complaint what his role in the fraud was. He further argues that because the SEC in certain limited circumstances used the phrase "and/or" to describe his acts, he also cannot ascertain what his role was. And all of this according to Mr. Kirk violates Rule 9(b).

As a threshold matter, however, Mr. Kirk argues that the SEC is somehow trying to mislead the Court, because in its complaint the SEC alleged that Ben Kirk and other people did something, whereas in the SEC's opposition papers, the SEC said that Ben Kirk said something. We think that's a nonsensical argument. As the SEC stated in its opposition brief, that John Kirk and Dylan Boyle, two of the main coconspirators with Mr. Kirk, have already entered into partial settlements with the SEC.

Consequently, it was unnecessary to describe in our opposition motion the facts relating to those individuals because they had settled and not filed motions to dismiss.

Consequently, we focused on Ben Kirk because he moved to dismiss the complaint.

With respect to the argument that the SEC has improperly pled under Rule 9(b) because they've grouped defendants together, we believe that this was totally appropriate. In *SEC v. Badian*, the Court held that it was proper for the SEC to name defendants together because they operated together as a unit. And each defendant committed the acts complained of.

The same is true in this case. And this reflects the facts that certain defendants worked together to effectuate the various aspects of the scheme. For example, in paragraph 47 of the complaint, the SEC alleges that Ben Kirk, his brother, John Kirk, Dylan Boyle and James Hinton set up two boiler rooms to promote Trade Show. And in paragraph 48, the SEC specifies that Ben Kirk and Boyle operated Skymark while John Kirk and Hinton operated Emerging Stock room. There is no question from these two paragraphs who did what.

And as this Court pointed out today, to the extent the SEC alleges that two people did something, this is not group pleading. This is because the SEC is alleging that each of those persons did those acts. This is a 50-page complaint, your Honor, with nearly 230 paragraphs. If the SEC had to state in multiple paragraphs that each individual did the same thing as the next, the complaint would be twice as long and

unreadable. And we do not believe that Rule 9(b) requires this. And we would refer the Court to 2013 decision called Szulik, S-Z-U-L-I-K vs. Tagliaferri. And in that case the defendants complained that the complaint violated Rule 9(b) because it referred to two of the defendants as if they were a combined unit no less than 298 times in the complaint. But the Court held that 9(b) did not prevent such pleading, finding that each defendant could determine the role that he played in the fraud.

And we say the same thing here, your Honor. Mr. Kirk can easily determine what it is that he did. We have set it out very plainly. And to the extent that two people are alleged to have done something, it's because those two people did that act.

Similarly, with respect to the "and/or" paragraphs, we ask the Court to pay attention to what is being alleged here. Going back to your bank robbery analogy this morning, your Honor, we don't allege that one defendant robbed the bank and/or drove the get-away car. In such a case a defendant might reasonably say that he doesn't know what he's being accused of. But in this case the SEC used the term and/or according to Ben Kirk, twice in the factual allegations and once in the recitation of the first claim for relief. So we don't use this as a crutch, as Mr. Kirk suggests.

And in these two instances, in the factual recitation,

the term and/or is utilized with respect to whether a defendant drafted and/or approved certain language in the stock touting e-mails and the public statements responding to the street sweeper article.

First, drafted and/or approved is different from the example I just gave in the bank robbery example. There is a fine line, your Honor, between drafting and approving language. And it is often difficult to determine exactly which person drafted and which person approved. And many times a person will do both. And as an outsider to these transactions, the SEC cannot be held to make such allegations with such specificity because this is information that is particularly and keenly within the defendant's own knowledge.

And second, for their liability purposes, it doesn't really make a difference whether or not they drafted or approved the language. Reliability would be the same, your Honor.

In addition to the 9(b) claim, Mr. Kirk claims that the SEC has failed to allege scienter. Here the SEC alleges both motive and opportunity and strong circumstantial evidence of conscious misbehavior or recklessness. And it's notable that Mr. Kirk does not even discuss motive and opportunity in his reply brief. And the reason for this is that it's uncontrovertible that he sold millions of shares of stock that he owned.

For Trade Show the complaint alleges that the nominee entities that he and Boyle controlled realize more than $4.4 million in proceeds from sales of over 5 million shares during a seven-month period. And for Pacific Blue, the complaint alleges that over a six-month period the Kirks and Boyle realize more than I think $5.6 million from stock sales. This is a concrete benefit.

Moreover, the complaint alleges opportunity to commit the fraud as he set up the boiler rooms that were promoting these companies, which increased the demand for the stock and also exercised control over the companies, even if he was not a named control person.

The complaint also alleges reckless conduct, first through the scalping, which by itself by its nature is reckless conduct.

Second, the use of the multiple fake offshore nominee accounts to conceal stock sales is evidence of scienter. If Ben Kirk didn't believe that he was doing something wrong, why did he need to sell his shares to not just one account in a fake name but in multiple fake account names?

Third, Mr. Kirk's attempts to cover up the scheme when it was discovered is further demonstrative of his fraudulent attempt, but the complaint is filled with allegations describing his fraudulent intent. He set up the boiler room. He wrote the Skymark script. He told the account managers to

watch the movie Boiler Room. He was highly involved in the language in Skymark's e-mails that said that Skymark was independent. He drafted and released the fake independent research report that Skymark touted as being independent.

Finally, in addressing the Section 20(a) claim, Mr. Kirk claims that his reply brief that the SEC did not provide any specifics with respect to the tasks that Ben Kirk performed in running Skymark's operations.

First, as a matter of pleading, the SEC is not required to particularize the allegations concerning control as set forth in the numerous cases alleged in our opposition brief, including In Re: AIG and Colombo, which make clear that allegations of control are not averments of fraud and are, therefore, governed by Rule 8 and not Rule 9(b). Your Honor's case In Re Sarnafi, which discusses particularized allegations, does so in the context of the third prong of control person liability, which is culpable participation and not with respect to the second prong, control over the primary violator.

But even if the SEC was required to allege control of particularity, it has done so. In addition to the fact that Ben Kirk established Skymark, the complaint alleges that he gave the script that the Skymark account managers used; that he instructed Skymark account managers to watch the movie Boiler Room so they would know how to sell stock. The complaint alleges that Kirk drafted the false and misleading statements

in Skymark's e-mails to customers, and that Kirk drafted the false research report that Skymark sent to investors.

Your Honor has also pointed out numerous other paragraphs in the complaint that demonstrate the allegations that particularize Mr. Kirk's control over the company. Consequently, the SEC believes that it has met its pleading obligations with respect to Mr. Kirk generally and also with respect to the control person liability claims.

I'll answer any questions your Honor has.

THE COURT: No, I think you've answered my questions.

MR. BRODY: Thank you, your Honor.

Your Honor, we can now address the Section 5 claims separately at your ...

MS. BROMBERG: Good afternoon, your Honor.

THE COURT: Good afternoon. I don't want to sell you short, but we probably had a lot of this discussion before.

MS. BROMBERG: I'll keep it short. I wanted to revisit briefly with you the scenario you were talking about with my colleague, Mr. Newville, about who is subject to the requirements of Section 5. And the prima facie obligation as you said, is simply that we have to meet an obligation defendant used the instrumentalities in interstate commerce directly or indirectly to offer to sell securities where a valid registration statement was not in effect.

Now, there are exemptions, and one exemption that is

available to ordinary people is Section 4.1, which says that offers to sell or buy securities are not subject to Section 5 if they're by persons other than an underwriter, issuer, dealer. In our complaint we have made allegations that all the defendants are underwriters or necessary participants in substantial factors. With regard to Dr. Carrillo, because he is an underwriter and --

THE COURT: Well, that's what I was going to ask, because I went back and looked at that. On what basis are you alleging he's an underwriter?

MS. BROMBERG: Great question. Well, first, I'd like to just also address, because I will address both issues, the arguments by counsel for Carrillo and Huettel that the shares from Pacific Blue were already registered pursuant to the 2007 SB-2 for Zonso (phonetic) travel agency. And we'll get to the underwriter issue through this discussion.

THE COURT: We've been through this discussion.

MS. BROMBERG: We haven't. We haven't addressed it yet. So the registration statements are in effect --

THE COURT: They persuaded me on that one. You can talk me out of it. You can't register one stock and then convert it into something else because you want to make people think they're getting something new and not reregister it. That's kind of a hard argument to make.

MS. BROMBERG: Terrific. So we'll move on to

Dr. Carrillo. When he obtained his shares, he obtained them in the same 2009 transaction that the Kirks, Boyle also obtained their shares. And that transaction was from a control person of the issuer, so those then became restricted shares.

THE COURT: Okay.

MS. BROMBERG: So the statutory underwriter provision is Section 2(a)(11). And that says -- you know, and that says the term underwriter means any person who has purchased from an issuer with a view to or offers or sells for an issuer in connection with the distribution of any security, or participates, or has a direct or indirect participation in any such undertaking, or participates or has participation in the direct or indirect underwriting of any such undertaking.

And the statute goes on to define the term issuer to include, quote, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer or any person under direct or indirect common control with the issuer, end quote.

So Dr. Carrillo obtained his shares from a control person in connection -- of the issuer.

THE COURT: I was listening for what you say -- what language applied to Dr. Carrillo? What way did he participate, in --

MS. BROMBERG: He purchased the shares from a control person.

THE COURT: But it doesn't say a purchaser of the share is an underwriter. That's not what it says.

MS. BROMBERG: It does. The term underwriter means any person who has purchased from an issuer with a view or who participates in any kind of distribution is an underwriter.

THE COURT: With a view?

MS. BROMBERG: Or --

THE COURT: Give me --

MS. BROMBERG: Or has a direct or indirect participation in any such undertaking.

THE COURT: But you're not saying he has any direct or indirect participation.

MS. BROMBERG: Well, with the distribution, yes, he does, because its shares are sold.

THE COURT: What was his participation? That's what I went through this morning. Nobody, nobody can articulate for me what his participation was. What was his participation?

MS. BROMBERG: He purchased the shares from a control person --

THE COURT: I'm sorry.

MS. BROMBERG: So he purchased the shares from a control person of the issuer, and then the shares are restricted securities and they are subject to the holding requirements of Rule 144, which he didn't comply with. And he did purchase the shares with a view to then sell them. And

that's all that's required under the statute.

THE COURT: But you don't say that. You don't say that.

MS. BROMBERG: We do.

THE COURT: You don't say Dr. Carrillo purchased the shares with a view to sell them. You don't say Dr. Carrillo purchased the shares at all.

MS. BROMBERG: May I point you to paragraph 146 of the complaint.

THE COURT: Okay.

MS. BROMBERG: We say the Kirks, Boyle, Hinton and Dr. Carrillo are underwriters under Section --

THE COURT: Yeah --

MS. BROMBERG: Because they acquire shares from an affiliate of the issuer with a view to public distribution and did not comply with the applicable conditions of Rule 144.

THE COURT: But that's a conclusory statement. In what way did Dr. Carrillo purchase the shares with his view of public distribution?

MR. BRODY: Well, he purchased them in the transaction in 2009.

THE COURT: Okay.

MR. BRODY: And then distributed them. So.

THE COURT: Wait a minute. That's true of everybody who buys and sells stock. That doesn't make everybody

underwriters. Every human being who purchases a share purchased it with the eye of some day selling it. That's not what you mean --

MS. BROMBERG: But not everybody who purchases the shares purchases it from directly from the issuer or control person of the issuer. And --

THE COURT: I know --

MS. BROMBERG: And people who buy shares, many of them aren't --

THE COURT: Slow down. That's not the definition you gave me. That's not what it means. It doesn't mean that because somebody gave it to me, that I automatically am the underwriter; because I purchased it, I am automatically the underwriter. Under that definition you're trying to put on Dr. Carrillo because someone purchased it in his name for him and he now owns it. That makes him an underwriter. That's your argument?

MS. BROMBERG: Because Dr. Carrillo himself purchased it from an affiliate of the issuer. That's the statutory definition. And then if he has even indirect participation in the distribution, that's the terms of the statute.

THE COURT: But what is his indirect participation?

MR. NEWVILLE: Having a brokerage account and either trading himself or having his son trade from that brokerage account and distribute the shares in the public distribution

that were control shares and in violation of the Rule 144 holding period in violation of Section 5, that's at the very least indirect participation. And that's the statute.

THE COURT: Wait a minute. Wait a minute. Slow down.

What allegation is there that Dr. Carrillo participated in any way in the purchase of these shares? And what do you mean to allege by that? When you say participation, I assume you're not talking about any active participation. Or are you? I mean --

MS. BROMBERG: There's the act of participation of buying the shares.

THE COURT: Did he actively participate in buying the shares?

MS. BROMBERG: Yeah. He wired money from a US bank account to Carillo and Huettel's trust account to purchase the Pacific Blue shares.

THE COURT: Okay. You say he wired -- and you believe that the wiring of that money was specifically so that he could buy the Pacific Blue share?

MS. BROMBERG: Yes.

THE COURT: Okay. All right. Okay. Go ahead. So your argument is dependent on his being defined as an underwriter?

MS. BROMBERG: Yes.

THE COURT: Because that's not the discussion we were

having earlier. So if I don't find him to be an underwriter, there's no other reason to keep him in this case? You can't have it both ways.

MS. BROMBERG: Well, yes, we believe he's statutory underwriter. I also wanted to correct one statement, which is that he sent the money by check, the 20,000 to buy the Pacific Blue shares, and not a wire.

THE COURT: Right. I didn't know whether that was significant. All right. So he is an underwriter because he received it directly from the issuer?

MS. BROMBERG: From an affiliate of the issuer, yes.

THE COURT: And but does it have -- it has to be with the intent for him to distribute, doesn't it?

MS. BROMBERG: There's not actually an intent. It's just if there's a direct or indirect participation in any distribution. That's within the statute.

THE COURT: How do --

MS. BROMBERG: Section 2(a)(11).

THE COURT: Tell me how I can have shares and not have by your definition a direct or indirect participation in the distribution.

MS. BROMBERG: Well, if you bought shares in an offering or there's registration statement, and you're just --

THE COURT: Well, that has to do with where the shares come from. I'm asking you about your definition of direct and

indirect participation.

MS. BROMBERG: Okay. So Dr. Carrillo purchased the shares from an affiliate of the issuer. He sold shares to the market. Now, if you were somebody who read the misleading information on Skymark and cited that you wanted to buy the Pacific Blue shares, then you could buy them and you wouldn't be buying them from the issuer. So you wouldn't be an underwriter. So in that case you would be able to claim that that 4.1 exemption.

THE COURT: So your definition of underwriter is someone who gets the shares directly from the issuer?

MS. BROMBERG: Yes, or an affiliate of the issuer.

THE COURT: But tell me if I'm wrong, and you may have a handle on this better than I. But my understanding of the intent and the definition of an underwriter is someone who takes the shares -- not because they intend to own them themselves, but they take the shares because they intend to temporarily hold them until they find a buyer. Is that an accurate statement?

MS. BROMBERG: I believe that is. And that actually speaks to what Rule 144 --

THE COURT: So what evidence is there, what allegation is there that that's what Dr. Carrillo did?

MS. BROMBERG: Because he, in fact, obtained the shares from the affiliate of an issuer and then distributed

them within the one-year holding requirement of Rule 144. And Rule 144 has a holding requirement on restricted securities in part so that people will hold the shares for at least a year before there's a distribution.

THE COURT: So did anyone ever find me the strict liability case that you were trying to rely upon?

MS. BROMBERG: Yeah. There's a whole bunch of them, but one of them is SEC v. Soft Point -- or, I'm sorry, SEC v. Burm Oil and Management, Southern District of 2007 case. I have it over there, and I can get you the language, if you'd like.

THE COURT: I don't want to, as I say, beat a dead horse here, but you see my problem. My problem is that your allegations are dependent upon my concluding that the act of the son Carrillo is sufficient to make the Dr. Carrillo a direct or indirect participant. And even your allegations -- I mean, as a matter of fact, even your allegations about the sale -- and you can point me to that paragraph -- even your allegations about the sale is that you don't even say that the son Carrillo sold the shares. You say that they were sold out of that account. You said the account sold them, is my recollection.

Do you know what paragraph I'm talking about?

MS. BROMBERG: I believe I do.

THE COURT: Which paragraph?

MS. BROMBERG: Well, I think you're talking about paragraph 150, but in paragraph --

THE COURT: 150, hold on. Slow down.

MS. BROMBERG: 148 --

THE COURT: Let me just look. I have all the Dr. Carrillo paragraphs with a "doctor" next to it.

I don't see that. I don't think that that's -- there's a paragraph that says that the shares were sold.

And also, while I look for that, also we had an earlier discussion -- I think it was earlier represented that Dr. Carrillo received $900,000. And the way I read the complaint was that the ultimate receipt of that money, that money was distributed to these other folks that you say were in this scheme that --

MS. BROMBERG: In part.

THE COURT: What money -- are you saying that moneys after the sale of the stock, $900,000, was received and retained by Dr. Carrillo? Because that's not the way I read it. And when I added up the numbers of where you say the moneys were distributed, there's no $900,000 left out of the sale of the $1.1 million of proceeds.

MS. BROMBERG: Well, let me just back up for a minute, just to kind of get back to the Section 5 allegations and the prima facie case that the SEC has made.

Once the SEC pleads the elements of the prima facie

claim, the instrumentalities of interstate commerce were used to offer or sell securities directly or indirectly, without registration statement in effect, then the burden to prove any exemption, including Section 4.1, which I mentioned earlier, is on the defendant.

THE COURT: Right. I understand that. They can't assert -- no defendant here can use as a ground for dismissing the complaint the fact that they intend to assert a defense.

MS. BROMBERG: Right. But claiming not to be a statutory underwriter, which we've alleged is, in fact, an exemption that would have to be argued by a defendant --

THE COURT: No. If that's your basis for saying that he's liable, you have to allege --

MS. BROMBERG: Right, and we did.

THE COURT: -- sufficient facts that indicate that he's liable on that basis. And you can't just simply call everybody an underwriter and that's good enough.

MS. BROMBERG: Right. No, we're not doing that. He's an underwriter because he acquired the shares from an affiliate of the issuer.

THE COURT: Look, you've got a bunch of smart lawyers over there at the SEC. And if you chose the language in paragraph 167, if you chose the language that an account controlled by Carrillo sold most of the Dr. Carrillo block of Pacific Blue shares, there's a reason you chose to word it that

way, okay? Because you don't have any evidence that Dr. Carrillo himself sold those shares, and you don't have any evidence to say -- and in this case you probably don't even have evidence to say Carrillo, the son, sold the shares because you don't even accuse him of doing it. You say an account controlled by Carrillo sold the shares. Well, there's no such thing. Somebody sold the shares.

And then you say that the shares were wired to a foreign account held in Dr. Carrillo's name. And then you give me a list of places where the money ultimately went to from the Dr. Carrillo account, I assume. And then you give me a list of all of the money that went elsewhere. And it doesn't -- I don't know where the representation is that Dr. Carrillo received $900,000.

MS. BROMBERG: Yes, there is no representation that he received the money. I mean --

THE COURT: Well, there was this morning. I was told Dr. Carrillo got $900,000.

MR. NEWVILLE: May I address this?

THE COURT: I assume you did not mean that that money was given to him and that's where it remained.

MR. NEWVILLE: Your Honor, let me just address this, and I think --

THE COURT: Because it's not in the complaint. You're confusing me.

MR. NEWVILLE: I can clarify the complaint.

Now, what we allege in paragraph 167 is that the majority of those proceeds were wired to the foreign account held in Dr. Carrillo's name.

THE COURT: Right.

MR. NEWVILLE: We don't have a specific number in there.

THE COURT: Right. But then you say 472 -- no, you do have a number. You say that the proceeds were $1.1 million.

MR. NEWVILLE: Right.

THE COURT: Then the next paragraph you tell me that $472,000 of the proceeds from the sale of Carrillo was wired to the offshore account in Barbados to the Kirk and Boyle accounts. And then you say $520,000 of the Carrillo proceeds were wired to accounts in California. Then you give me the list of all the accounts.

MR. NEWVILLE: Correct.

THE COURT: That adds up to almost $1.1 million.

MR. NEWVILLE: That's right.

THE COURT: So where's the $900,000? What $900,000 are you referencing? You confused me.

MR. NEWVILLE: I'm sorry, your Honor.

THE COURT: You just said this morning, you referenced that $900,000 went to Dr. Carrillo.

MR. NEWVILLE: Yeah. I believe that $900,000 went to

the account in Mexico, which was the account in Dr. Carrillo's name. And we can --

THE COURT: And that's the money you say then, therefore, then went to other people?

MR. NEWVILLE: Let me explain to you what happened.

THE COURT: No. You've got to answer my question because you're going to confuse me. That's the money that you are referencing here. You're not saying that that $900,000 stayed with Dr. Carrillo; that's not what you meant to represent, is that right?

MR. NEWVILLE: That's right.

THE COURT: You're saying that $900,000 was wired to the Carrillo related accounts in this manner and then distributed to these other people that had been personally in the pump and dump scheme? That's basically what I understand?

MR. NEWVILLE: Here is the issue. In paragraph 168 --

THE COURT: That $472,000 of proceeds, right?

MR. NEWVILLE: That just went to an offshore bank account. We don't know which one controlled that. We don't know how they divided it up.

THE COURT: Yeah, we do. You say bank account in Barbados where the Kirks and Boyle sent their proceeds.

MR. NEWVILLE: It was the same account. Everybody was sending all their funds there.

THE COURT: It wasn't a Dr. Carrillo account? You

don't claim it was a Dr. Carrillo account?

MR. NEWVILLE: Well, we know that it's an account where he sent the proceeds.

THE COURT: You don't claim it was a Dr. Carrillo account?

MR. NEWVILLE: No, we don't, your Honor.

THE COURT: That's all I'm asking. You don't say that, but you don't want me to believe that Dr. Carrillo got the money out of Barbados back; that's not what you're trying to have me believe, right?

MR. NEWVILLE: Well, no, your Honor. We can't draw any conclusions at this point --

THE COURT: All right. So Dr. Carrillo did not personally receive as a profit to him $900,000 that you are alleging?

MR. NEWVILLE: Well, it would certainly be strange if somebody could avoid liability simply by just sending the money to an offshore account.

THE COURT: You know you're trying to get to my ultimate point if you're trying to figure it out, and I'm not trying to make a point. I'm trying to ask a question, a factual question.

You're not alleging that Dr. Carrillo received a profit personally of $900,000 on the sale of this stock?

MR. NEWVILLE: No, we're not alleging that.

THE COURT: That's all -- I mean, as I say, I just wanted to make sure I knew what $900,000 you were talking about because there's no $900,000 reference that Dr. Carrillo personally received in this complaint.

MR. NEWVILLE: That's right, your Honor.

THE COURT: All right. So by your laying out these facts, 67 through 70, how much of this $20,000 are you contending went back to Dr. Carrillo personally?

MR. NEWVILLE: How much of the 520?

THE COURT: No, how much of the initial investment?

MR. NEWVILLE: We're not sure how much was retained by Dr. Carrillo.

THE COURT: Okay. That's all I'm asking. You don't know.

MR. NEWVILLE: We don't know.

THE COURT: Okay. But all of this money -- approximately how much money that was distributed through the Carrillo account and went to other places, how much of the $1.1 million does this add up to?

MR. NEWVILLE: Well, I believe what we've got is the 343,000 is part of the 520 that was sent to California.

THE COURT: Okay. You have 472,000 plus 520,000?

MR. NEWVILLE: Right.

THE COURT: Okay. So if my math is right, that's 992,000 of the $1.1 million you know were -- didn't stop in

Dr. Carrillo's account.

MR. NEWVILLE: Right. Those are the amounts that went through the account in Mexico.

THE COURT: And what about the -- okay. All right. Okay. Go ahead, because I want to wind up in a minute.

MR. BRODY: I'm not sure --

THE COURT: Try to finish this up in the next 20 minutes.

MR. BRODY: I'm not sure --

THE COURT: My time is 20 minutes.

MR. BRODY: Sir, we can address the venue and process issues, if your Honor wants us to address those.

THE COURT: Yeah. Remind me of the venue issue. That was --

MR. BRODY: That was Mr. Huettel argued, and I think the Carrillo Huettel -- maybe Carrillo, too.

MR. CURRAN: Mr. Fleming argued that on behalf of whoever it may apply to, but certainly Mr. Carrillo.

THE COURT: Go ahead. I mean, I'm not sure what -- I had to remember the venue argument. Venue should be where?

MR. NEWVILLE: And, you know, as you're aware, we've pled this case here in New York. Mr. Huettel and apparently the firm and Mr. Carrillo would prefer it to be in San Diego. But we believe that venue here is appropriate not only under the coconspirator theory of venue, which I think your Honor

touched on when we were here last, but also through the Mr. Huettel's own acts.

And paragraph 131 of the complaint -- Mr. Brody referenced this before -- Mr. Huettel drafted, and he and Carrillo provided, a letter that was addressed to the DTC in this district. So as we've discussed in our brief, that was an important step in the execution of the scheme. And it was a step that Mr. Huettel and Mr. Carrillo took themselves. In a scheme liability case, that's enough to grant venue over the entire case.

THE COURT: Well, was there argument -- you have to remind me. I'm sorry. Was there argument that venue was improper here, or is their argument that venue is more appropriately transferred to California?

MR. NEWVILLE: We've got both arguments. So they've argued that venue is improper, and in the alternative, they'd like it transferred.

The second point on whether venue is appropriate here is under the coconspirator theory. In a scheme liability case the venue is proper as to all defendants so long as venue here is established as to any defendant. We believe venue is established as to Carrillo and Huettel on that opinion letter.

In addition, paragraph 14 of the complaint notes that certain defendants solicited investments from investors in this district, and the defendants sold securities through a broker

located in this district.

THE COURT: Well, you know, let me stop you there. You don't have to make a strong argument. This is not compelling. The only person in California is Carrillo and Huettel, if they're still in California. And they say the law firm is even defunct, so it's not even a law firm I have to consider is a valid defendant for venue purposes in terms of being compelling to send it to California. Nobody else has any contact with California. In fact, Mr. Carrillo is a New York lawyer. So venue, I think, on the basis of what you argued, it is appropriate here.

If there was some other compelling issue, and most of these defendants and most of the records and parties were in California, it might be more compelling. But, quite frankly, most of these people are international, so it's not a very compelling reason to tell anybody they've got to go to California simply because Mr. Carrillo and Mr. Huettel want to be in California, because that's where they're from.

MR. NEWVILLE: Your Honor, I think the only other point I wanted to make, Ben Kirk's counsel today made some arguments about whether service process was appropriate as to his client. I just want to correct the record on one point.

He had asserted that the SEC should have gone to Ben Kirk's court appearances in Alberta and that he has not missed a single court appearance there when his presence was required.

I think that statement is, at best, misleading. According to the Alberta Securities Commission, Ben Kirk's appearance has not been required at any court proceedings. They couldn't find him, and they only served him when counsel showed up on his behalf and agreed to accept service. So they're not quite sure where Ben Kirk is either. That said, if you have other questions as to service and the reasonable efforts we took, I'd be happy to answer.

THE COURT: No. I'll let anyone else who wants to briefly respond respond, then I'm going to end.

MR. MARCELINO: Your Honor, I would actually like to briefly respond to some of the SEC's assertions. And I'd start out by saying a very good lawyer sometimes recognizes when it's time to sit down and just be quiet and not say anything further. I'm hoping that I don't preclude myself from such consideration.

I couldn't help but want to jump up during some of the staff's arguments, particularly with respect to Section 5, your Honor. In summary, in the assertion that Dr. Carrillo is somehow statutory underwriter and, thus, strictly liable, as this staff stated, a statutory underwriter is defined in Section 2(a)(11), okay? All being a statutory underwriter means is that you're not eligible for a Section 4.1 exemption. 4.1 exemption covers private transactions. A statutory underwriter the exemption is not eligible, but you still have

to go through the next step of establishing a Section 5 violation.

The staff has asserted participant liability. As all of the participant liability cases make extremely clear, with regard to participant liability, it's not a strict liability standard. You have to demonstrate that somebody was a necessary participant or a substantial factor. And I think that it's been misleading to assert this. And I'm not saying that it's done intentionally, but part of the problem I speculate is that you have a group of enforcement lawyers talking about a corporation finance issue. I don't concede that Dr. Carrillo is a statutory underwriter, but if I did, I'd simply say whoop-de-doo. It doesn't mean he violated Section 5.

The other point that I would like to make, going back to the earlier jurisdictional arguments, your Honor, I'm kind of -- if this wasn't such a serious proceeding, I'd find some humor to it, because I see the staff is just running from their complaint. And I want to pause at that.

You should live by your -- if you live by your complaint, you drag somebody into court, you should die by your complaint. How the staff runs from paragraph 150, which strongly -- you know, we talk about all the inferences. I can't read paragraph 150 and walk away from that and say Dr. Carrillo was selling these shares. They want to run from

that and interject a lot of facts which are not in the complaint. And I just would like to remind the Court that traditionally, a plaintiff in establishing personal jurisdiction, it must be based on allegations in the complaint. I quickly cite *Ball v. Metallurgie*. It's 902 F.2d 194. Conclusory allegations and statements must be ignored by the court. *Melnick v. Adelson-Alelnick*, 346 F.Supp. 501 (Southern District 2004).

And lastly, when the plaintiff fails to submit documents or an affidavit, the Court is limited to the allegations in the complaint. Again, this matter was filed a year ago. The staff has had ample time to file affidavits with additional facts, and they haven't. The Court shouldn't consider them.

And the last point that I would like to make -- I know everybody's had a long day, your Honor -- but I would take issue with the cases that the staff has relied on with respect to jurisdiction. I think you seized on the moment correctly when the staff was discussing *Unifund* as you distinguished that case pointing out that it involved an insider trading case. *Unifund* is actually a fun case I think for lawyers to read in that there's a lot of hyperbole on each side in front of the Court. On the one hand, in determining whether to apply jurisdiction over a foreign defendant, the SEC ran around in that particular case and said, you know, our markets won't be

viewed as fair if you don't bring this person under our jurisdiction. It won't impact the integrities of the markets. The defendant posited, if you bring my guy in from a foreign country to defend this, foreign investors will stay away. The judge amply demonstrated to each side that he thought that that was a bit excessive, and they put forward -- and I don't argue with the SEC on the law in *Unifund* that they rely on. *Unifund* -- and I'm quoting from the SEC's brief here on page 83 -- *Unifund*, it says that to exercise jurisdiction over a defendant when the conduct and the connection with the forum state as such, they should anticipate being held with the Court.

Total agreement there. What I disagree on is how they apply that standard. Because one of the things that the SEC wants to continually assert that these cases stand for, the proposition that Dr. Carrillo should be subject to this jurisdiction. You know, when I look at *Unifund*, it supports the point that you're making, your Honor. Right after shooting down the hyperbole on each side, *Unifund* says, and *Unifund* did, in fact, find that there was jurisdiction over the extraterritorial defendant. But they go on to explicitly state not every securities law violation involving shares of a United States corporation will have the requisite effect within the United States.

This is the important part. It goes on to point out,

as you perceived, insider trading, however, has serious effects that can reasonably be expected to be visited upon US shareholders where these shares are traded exclusively on a US exchange. The other case that they rely on, the *Soft Point* case, is no different.

THE COURT: You don't have to go through that. I have *Soft Point* in front of me, and *Soft Point* specifically says *Unifund* holds that a district court may exercise its personal jurisdiction in a securities action so long as the defendants' activities had, quote, an unmistakably foreseeable effect within the United States and could reasonably be expected to be visited upon the United States shareholders. That's what I take from *Soft Point*. And if there's some other section in that you think is more directive than that, you can tell me.

MR. MARCELINO: No. And I think that when you look at *Soft Point* in terms of the background of facts that got the Court to where it was, it's certainly, I think, not the case to use to suggest that Dr. Carrillo should be hailed into court here, in that that was a particular case that the jurisdictional issues were challenged after judgment. It didn't involve an extraterritorial defendant. It actually involved a narrow question of jurisdiction in the state forum or nationally, because of the securities law issue.

And you had a defendant, recalcitrant defendant whose own counsel withdrew from the case. He was convicted, fines

levied, who later shows up and then tries to challenge jurisdiction. You know, I think none of us here would want to be dealt that hand and have to go and argue to the Court you shouldn't exercise jurisdiction over this gentleman who did his acts in Nevada. So I just thought *Soft Point* was a totally inappropriate case.

THE COURT: All right. Thank you.

Anybody else want to be heard? Yes.

MR. CURRAN: I think I can do it right from here, Judge, if you can hear me.

MR. MARCELINO: Thank you.

MR. CURRAN: First, on the point of whether Pacific Blue was registered, I draw your Honor's attention, paragraph 26 of the commission's complaint, second sentence of which reads, Pacific Blue registered an offering of its common stock on a form SB-2 that became effective in September of 2007 and made quarterly and annual filings with the commission through 2011.

There seems to be an assumption, Judge -- and I know you cut counsel off about whether these Pacific Blue securities were registered or not. We believe they were.

THE COURT: Okay.

MR. CURRAN: Two, there's been a lot of discussion in this case about the use of the trust account and how that is a deceptively -- an inherently deceptive act. Well, a lot of

talk of that without any support for that premise. We don't believe that it's inherently deceptive. As a matter of fact, just the opposite.

Under California rules, and specifically, California Rules of Professional Conduct 4-100(b), a lawyer should promptly pay or deliver as requested by client any funds, securities or other properties in the possession of the member lawyer which client is entitled to receive. And there's a case T & R foods, 47 Cal.App. 4 Supp. 11996, Judge. The purpose of Rule 4-100 is to provide against the probability in some cases, possibility in many, endangering all that commingling will result in the loss of clients' moneys.

Frankly, Judge, I think that the use of the Carillo Huettels trust account is not deceptively -- it's not deceptive at all, not inherently deceptive. It's meant to simply segregate Dr. Carrillo's money and original clients' money. And it wasn't deceptive, didn't have a deceptive purpose at all.

THE COURT: The question on this or this motion is not whether it has a deceptive purpose, but whether or not one might draw an inference that that would not be the usual or the preferable way to transact business on behalf of a client. I assume most of your trust accounts in which you hold funds for clients are held in the separate account under that client's name.

MR. CURRAN: They don't let me near those, Judge.

THE COURT: I assume that's the standard practice.

MR. CURRAN: I can only tell you that client funds are put in trust held for them, and that's all the trust account is. So if Dr. Carrillo sent to Carillo Huettels $20,000 for the purposes of investment, it was held in that account for his purpose. It's not their money.

THE COURT: That may be true. But I can't determine that on --

MR. CURRAN: But it's not, as Mr. Brody implied, inherently deceptive. It's just not.

Just give me a second, please, your Honor. The complaint by counsel's own, and as your Honor points out, who directed the sale of the P-back stock, there's a lack of specificity on that. Mr. Newville said at one point that it wasn't relevant. Quote, the decision of who made the decision to sell is not relevant. They are not saying that Dr. Carrillo didn't. They're not saying that he did. They're not saying that Luis Carrillo didn't. They're not saying that he did. There's a lack of specificity, frankly, as to that direction.

But let's be clear about what that transaction was. And Mr. Newville was quite candid, I think, despite the statement that he's not at liberty to disclose facts not in the complaint -- kind of a cryptic thing that we'll discuss at some point in this case I anticipate in more detail. But when he

was candid, he was saying that the stock was sold out of the Canadian account at whoever's direction, perhaps pursuant to the power of authority granted to his son.

THE COURT: That would be the reasonable inference.

MR. CURRAN: But it wasn't a power of attorney granted for this security. And I think the commission would even concede that. It was an old power of attorney. It was long existing. It wasn't --

THE COURT: But still, he had the authority and --

MR. CURRAN: Okay.

THE COURT: -- it is reasonable to read from this complaint that he exercised that authority when he purchased the shares for his father.

MR. CURRAN: Well, you know, his father sent a check to him for the purpose of buying the shares.

THE COURT: So he's got the check. Exactly.

MR. CURRAN: But the 20,000 goes into the trust account. It's the father's money. The father says, buy shares. It is not Carrillo's money. He uses it properly out of his trust account to buy shares. The stock is sold out of the Canadian account for 1.1 roughly, okay? $900,000 of that is transferred to Dr. Carrillo's accounts in I believe Mexico and in the United States.

THE COURT: Right.

MR. CURRAN: And they had to be transferred to an

account in Dr. Carrillo's name pursuant to Canadian anti-money laundering rules I'm told, okay? So there's 900,000.

THE COURT: All right. So who does that help other than Dr. Carrillo? How does that help your client?

MR. CURRAN: I don't see where we come back to the 472,500, Judge.

THE COURT: Well, I don't either, but that's not -- I mean, I just need -- that's neither here nor there --

MR. CURRAN: You add up the numbers, it's impossible.

THE COURT: What's impossible?

MR. CURRAN: You take 1.1 and you add up to 472,500, the 520,000, the 350 that's alleged to come back to the trust fund, which was Dr. Carrillo's --

THE COURT: I know. I already came up with 900-something, $992,000. But --

MR. CURRAN: And I believe they know exactly what the numbers are.

THE COURT: Okay. But I don't see how that gets your guy off the hook.

MR. CURRAN: I don't think he should be on the hook at all.

THE COURT: But why does that get him off the hook?

MR. CURRAN: It's indicative of some of the artful drafting of this complaint that your Honor has alluded to.

THE COURT: I noticed the artful drafting.

MR. CURRAN: I wrote it down.

THE COURT: I mean, as I say --

MR. CURRAN: I'm on with the cab driver thing. I thought that was excellent, too.

THE COURT: There's one rule about artful drafting. If they could have said it stronger, they would have, okay? That's the definition of artful drafting.

MR. CURRAN: But I think they could have said it stronger, and I think that they're playing hide the ball. And I think it's unnecessary.

Thank you, Judge.

THE COURT: Yes, sir.

MR. FELDMAN: Your Honor, I want to just 30 seconds to respond to one point proposed by the commission, by the staff here, your Honor. They cited the case *SEC v. Badian* on this group pleading concept, the idea that they're saying it's proper to name the defendants together, John Kirk, Ben Kirk, Boyle, all together because they operated as a unit. And they cited, Judge Swain's opinion in *SEC v. Badian*. What Judge Swain said in *Badian* was that they had -- it was sufficiently particularized, even though they named them in a group, because the complaint specifically alleged that, quote, they operated as a unit, unquote, and that, quote, each, unquote, of the individuals took the particular offending acts.

We don't have that allegation here. They didn't

allege that they operated as a unit, as *Badian* said, or that each of the people named in these group pleadings took the offending acts. So, yes, you can do group pleading if you say each of these people did each of the things we list here. But they didn't do that. And so *Badian* actually, your Honor, goes against the SEC's position here. And it points out why this is not sufficiently particularized and how they could fix it, if they want to.

MR. FLEMING: Your Honor, I'll be quick, perhaps a sonic attempt to try to persuade you. But hear me out for just a minute.

Mr. Newville talked about, as Mr. Curran said, not being at liberty to divulge SEC information, which I think gets to the heart of what our -- and I'm Mr. Huettel -- our main complaint is. They reference e-mails and communications as supporting the knowledge of the lawyers that there's a fraud here, but they don't cite any of the e-mails. They don't cite any of the communications.

And they then cite the *Shields* case, the Second Circuit case discussing this very issue. But what *Shields* says is conclusory allegations that defendants knew but concealed some things or knew or were reckless in knowing other things do not satisfy the requirements of Rule 9(b). Such allegations are so broad and conclusory as to be meaningless. That's the Second Circuit.

And I think that in a case like this, where the SEC is alleging fraud against a lawyer, and that Mr. Huettel's case, the worker bee partner of this firm who does stuff in the background, it's ruinous for him to stand there and have a fraud claim against him unless they're going to go out and spell it out. They're going to say, he's on this e-mail. There's this communication. Mr. Huettel said this. Someone said this to him. And that is a bare minimum requirement of theirs.

And I think that the notion that they're not at liberty to divulge information really, really misses the point in a fraud case. That's exactly their obligation. They're not free to say, we can't divulge this. That's really --

MR. CURRAN: If they haven't request not just, quote, one of them, Judge, but they keep citing to these e-mails, and we don't have them.

THE COURT: I assume that's the first thing you'll ask for in discovery.

MR. CURRAN: Maybe not the first thing. Maybe not the first thing.

MR. BRODY: Your Honor --

MR. FLEMING: But in the meantime, he's standing there accused of fraud by the federal government.

THE COURT: But my analysis is not whether or not you think they're hiding the ball with regard to those allegations.

My analysis of it has to be whether or not, even despite that, there are sufficient factual allegations that would keep your client in this case no matter what.

MR. FLEMING: I understand.

THE COURT: That's the --

MR. FLEMING: I would argue that the allegations made are not factual. They're conclusory.

Last quick point on the venue point. I realize your Honor may have already decided that. But Mr. Newville referred to an opinion letter that Mr. Huettel did not sign being sent to the DTC in New York. In our brief we cited that it's not the place where the opinion letters are received that establishes venue, it's where they're transmitted. That would be California, of course.

MR. BRODY: Your Honor --

THE COURT: Let me just let defendants finish, then I'll wind this up.

MR. SALLAH: Your Honor, briefly, on behalf of Mr. Hinton, I'm not really sure what -- other than clarifying that Mr. Hinton out of the $11 million made 32,000 from the sale of this stock as part of this alleged group, and I appreciate that concession by the staff, I don't know what was added; that there was a brief argument or mention that, your Honor, one scalps, one scalps if one talks about a stock and is selling the stock at the same time. By doing that in and of

itself one assumes the duty.

Your Honor, that statement comes from the *Zweig* case, which predated *Chiarella*. And while the staff wants to hang its head on that case, which was cited in our papers, the Ninth Circuit, who drafted *Zweig* said, post-*Chiarella Zweig* and the Feldman case, *Zweig* may be distilled thusly where a financial advisor gives advice with regard to a stock he or she intends to purchase, he has a conflict of interest. And if that conflict is not apparent to investors, he is under a duty to disclose the conflict.

Your Honor, I submit nothing in the SEC's complaint brings Mr. Hinton into the role of a financial advisor who would have duties. *Chiarella* is the law of the land. And the staff cannot run from it no matter how much they'd like to. And even if your Honor was going to listen to the staff about this theory of assumption of the duty doctrine, one should go back to the Ninth Circuit which came up with it and then later corrected itself after *Chiarella*.

Thank you, your Honor.

MR. GOUREVITCH: Your Honor, very briefly. It is late in the afternoon, and I would like to come very briefly back to the timing for Mr. De Beer, because it is quite important for him.

The staff talks about the transfer of the stock in the oral argument as having occurred in 2009. In fact, the

complaint alleges that it occurs as early as 2008. And its scheme starts in 2009, and the pump and dump scheme starts in 2009. They also allege in paragraph 35 that the press releases -- that there are press releases issued, but unlike the staff has said in the oral argument, there is no allegation that press releases are issued throughout the course of the scheme. It simply said in the course of -- in the structure of the complaint, it suggests that they are issued even prior to the transfer of the stock.

Secondly, your Honor asked -- you talked about the significance of the transfer of documents directly to the Kirks. And I would like to come back to what your Honor said. I think your Honor said the most you can derive from that is that they had some connection to the transaction. And I think that it actually puts it quite succinctly. You cannot address -- you cannot draw more from that.

The third point is that the SEC has talked about the $330,000 payment which it has labeled as kickback. That's a legal conclusion, and that's all it is. It's unsupported by any factual basis. The complaint alleges no connection, no basis whatsoever as to what the reason for the payment was at all, nor does it allege that Mr. De Beer had any knowledge that it was from the sale of stock.

Thank you.

MR. POSSIDENTE: If I may be heard briefly on behalf

of the law firm.

SEC made the argument that the law firm's argument where we're a defunct entity, we ought to be out of the case because there's no purpose for us to be in the case, is premature, that's really not true. It's a procedural argument. It's your Honor's inherent power to control the docket, and under Rule 21, your Honor's ability to add or drop parties on good cause, and we would submit that that cause exists.

THE COURT: I'm not sure what record I have to make that determination at this point.

MR. POSSIDENTE: Well, I think, as our brief pointed out, and as Mr. Devaney pointed out during the argument previously, this is a defunct entity.

THE COURT: How do I know that? What does that mean? Does it have assets? Does it have employees still?

MR. POSSIDENTE: No.

THE COURT: Is it active? Is it inactive? Does it --

MR. CURRAN: It shut down.

THE COURT: Is it still an existing entity that could sustain liability? Is it still subject to lawsuits? I don't have any record to make that determination that somehow they should be out of here because they don't exist. I don't know if that's a legal argument anyway but...

MR. CURRAN: Judge, the reason the Venable law firm exists is there came a time when, because of counsel's concern

about potential conflicts between the individual partners and the law firm, document retention and certain issues that we perceived, we thought the law firm ought to have its own counsel.

So there is no location. There is no law firm locus anymore. I'm an officer of the court and I'm telling you this. There's no law firm anymore. There's no clients anymore. There's no offices. There are no employees. There's no telephone. There's no website.

THE COURT: The law firm is wasting its money paying your bill.

MR. CURRAN: Well, but, Judge, the reason -- I represent the individual.

THE COURT: Right. But I'm saying, it's a little awkward to come in and say, I'm the lawyer for the defunct company that doesn't exist. Okay?

MR. CURRAN: Judge, you got to understand, the reason why -- it relates to why. And this was in actual caution in respect to the commission's investigation. We set up a law firm to represent the law firm separately in order that they could gather documents, that they could do certain things without any inference from the commission that we as counsel for individual partners were doing anything as regards to that. And I think that that's going to be important here somewhere down the road, Judge.

THE COURT: It may be.

MR. CURRAN: That's why.

THE COURT: But as I said, those issues are so premature for me to try to analyze the consequences of letting you in or out, simply because you say you shouldn't be here because you don't exist. I mean, I've heard those arguments before, and usually it's to your advantage to come here and say you don't exist.

MR. CURRAN: The individuals aren't asking for out, Judge. I mean, under agency law and partnership law, anybody who could be responsible for the law firm's obligations are here before the Court.

THE COURT: Well, I would continue to make that strong argument to the SEC. Maybe they'll realize they're wasting their time.

MR. CURRAN: They don't listen to me very well, Judge.

THE COURT: I don't know why they're proceeding against the law firm, or any of the other defunct companies, but there are theoretical reasons why they do the things they do. And they usually ask me for injunctions for certain things that I think are totally useless injunction, but I give it to them because they're legally entitled to them.

So let's wind this up.

MR. PATTERSON: Your Honor, could I just have 30 seconds for Gibraltar on the fraud claim.

THE COURT: Yes, sir.

MR. PATTERSON: Philip Patterson, DeFeis O'Connell & Rose for Gibraltar and Davis.

Earlier today your Honor asked the SEC where the allegation is in the complaint that Gibraltar intended to participate in the specific Trade Show and Pacific Blue alleged pump and dump. The answer from the SEC was, there were red flags and so Gibraltar knew that it was participating in that specific fraud.

I'd just like to ask your Honor to read paragraph 110 of the complaint, the second sentence. I'll actually read it: Gibraltar's business, according to the SEC, primarily consists of liquidating low priced, thinly traded stocks on behalf of its clients, often during periods of suspicious promotion.

Now, when your Honor asked the SEC where the red flags were for which one could reasonably infer that Gibraltar specifically intended to join this Pacific Blue and Trade Show pump and dump, your Honor said, are you talking about paragraph 140 to 142? And the SEC said yes.

So I'd like to read from paragraph 141. This is the purported red flags from which we can infer that Gibraltar intended to participate in the Trade Show and Pacific Blue pump and dump. I quote, paragraph 141, here, numerous red flags existed, including the sale of blocks of a low priced, thinly traded issuer. In short, as your Honor's questioning

indicated, the red flag, or at least one of the red flags, according to the SEC, from which we can tell that Gibraltar knew it was participating in a fraud, is what, according to the SEC's own complaint, in paragraph 110, says Gibraltar does on a daily basis. It's not a red flag. Whether the SEC wants to call it misrepresentation or a scheme liability, all they have is Ben Kirk opening three accounts in corporate names. That is not enough of a red flag to demonstrate that Gibraltar intended to participate in the Trade Show and Pacific Blue pump and dump.

Nothing further, your Honor.

THE COURT: Yes, sir.

MR. BRODY: Your Honor, I don't want to respond to the, I guess, defendants' arguments. What I wanted to raise, your Honor, is that the parties wrote a prehearing checklist which was submitted to the Court on January 17, 2014. In the checklist there is a dispute between the parties about whether discovery should continue while the motion to dismiss is pending. Your Honor, it's the SEC's --

THE COURT: I'm going to resolve that today because I'm ruling. So I'll rule orally, all right? That was my intention.

Obviously I've thoroughly reviewed all of the papers and thoroughly heard the arguments with regard to both cases. Let me first start with the first Gibraltar case, 13 CV 2575, I

believe, Gibraltar and Davis.

They're accused of operating as an unregistered broker. I heard argument, the first argument on that, and offering and selling unregistered securities under 15(a) and 5(a) and 5(c). I find that that complaint is sufficient; that if you read the facts in that complaint with the reasonable inferences that should be drawn in the SEC's favor, they sufficiently state a cause of action to support the claims in that complaint. I'll just highlight some things so the record is not too long but the record is full.

There's a website. They have a website. They claim primarily that they had a website that was soliciting prospective US customers. The facts as were alleged was that the website advertised the formation of an offshore international business corporation with nominee officers and directors that enabled US customers to trade anonymously without paying taxes on their profits. That was the allegation by the complaint.

Some of the underlying facts that were alleged in support of that was that the company, Gibraltar, and Davis, its principal, accepted deposits of Micro-cap stocks from US promoters and brokers, arranged for the transfer agent to retitle the stock certificate in Gibraltar's name, deposited shares from Gibraltar's securities accounts at US broker dealers, gave sell orders with US brokers, instructed US

brokers to wire sales proceeds to accounts in the Bahamas, and Gibraltar wired sales proceeds minus 2 to 3 percent commision to US customers. They sold $100 million in securities on behalf of US customers.

The website, Gibraltar, was never registered with the commission as a broker-dealer. They also engaged in transactions specifically with Magnum D'or, a Nevada corporation headquartered in Fort Lauderdale, Florida, which was the issue of one of the sets of allegations. They, as I say, primarily relied upon by the SEC that the website solicited US customers. Quite frankly, I don't find the facts to be particularly strong in that direction, but I think the facts are such that a reasonable finder of fact could review those facts and could reasonably conclude that that is what, in fact, was occurring.

For example, it described itself as a broker-dealer registered in the Bahamas. They offer, quote, offshore brokerage services with commissions comparable to those on the mainland, quote, mainland.

It indicated that using a Gibraltar offshore brokerage account will enable you to trade on most stock exchanges in the world at a cost equivalent to that incurred using mainland brokers without paying taxes on the profits.

It promised prospective customers, quote, an extra layer of confidentiality to protect assets from, quote, the

government seizure or frivolous divorce settlement, closed quote.

It showed price volume graphs solely for US market.

It was written only in English.

It charged fees in US dollars. There's no provision for currency exchange.

It referenced transfers of shares through US depository institutions.

To sell in securities in the United States consistent with that as alleged, Gibraltar created numerous accounts at US brokers.

Davis is alleged to have submitted false IRS W8 benefactor beneficiary withholding forms to US brokers certifying that it was the beneficial owner of the income relating to the securities account. And it's alleged Gibraltar held shares, quote, for the benefit of, closed quote, US Customs. Gibraltar nor Davis, as I indicated, was registered as a broker-dealer. Gibraltar participated in unregistered offers and sales of Magnum D'or stock -- in particular, 11 million shares, I believe, my recollection is used more than 600-plus transactions in those shares of US coverage.

With regard to any viable defense that's available, including the lack of knowledge of the scheme or lack of solicitation or any other foreign broker-dealer exemption, that is not appropriate to serve at this stage to warrant dismissal

of that complaint. So I am going to deny the motion to dismiss that complaint against Gibraltar on that basis.

There was also an application to consolidate this other case, this case. I'm going to deny that motion without prejudice to renewal for trial to see whether or not at that point consolidation is appropriate. But I will order coordinating discovery, and you should talk about a new schedule for discovery for both of these cases.

With regard to this case, let me first say that I'm going to grant at this stage only two motions. I'm going to first grant Dr. Carrillo's motion.

Obviously I have grave concern, and I've not been convinced by looking at the case law or the complaint or hearing the argument, that there's a sufficient basis to assert jurisdiction over Dr. Carrillo. The crux of asserting jurisdiction, which the SEC has not sufficiently concentrated on and given me a basis to conclude that Dr. Carrillo himself was involved in any -- in every case describes him, his conduct, activities, any actions on behalf of Dr. Carrillo, that Dr. Carrillo should reasonably expect that those actions would drag him in a court in the United States. There's not sufficient evidence that Dr. Carrillo took any active role at all in the purchase or sale of the stock that was done in his name. As a matter of fact, nothing in the complaint will give any impression that the SEC believes that Dr. Carrillo is an

active participant in any of this activity, or that Dr. Carrillo was taking any role, other than sending the $20,000 for the initial investment, giving his son the authority to trade on his behalf and, quite frankly, receiving moneys that went through his accounts and went right back to the defendants that the SEC says are participants in the scheme.

I can't identify any activity or any conduct by Dr. Carrillo that one can reasonably say that Dr. Carrillo should have reasonably expected that that conduct, his action, would possibly haul him into a US court, because some actions of his would have some consequence on US investors, particularly given -- I don't need to go through the back and forth about being an underwriter. I think still there's some requirement to show that Dr. Carrillo had some purposeful activity that he could reasonably expect that would have an effect on US investors, or he should reasonably expect that would drag him into a US court.

And additionally, with the sale of the stock, it's only a significant inference that the SEC wants me to draw that US investors were affected at all or had any relationship to the sale of that stock, since the sale of that stock was in Canada and not in the US. I'm supposed to draw the inference that because it's a US company, that Dr. Carrillo himself should have expected it would have some US effect on US

citizens when the stock was sold in Canada. And, quite frankly, there's not even an allegation that he even was aware that the stock was sold in Canada or when the decision was made to sell the stock, whether he had any participation whatsoever; or even any knowledge whatsoever at the time the stock was sold that the stock was being sold.

So as I say, by the nature of the artful drafting with regard to Dr. Carrillo -- and, quite frankly, it's difficult for me to find an active verb that corresponds with Dr. Carrillo in this complaint. I don't think there is an active verb that corresponds to Dr. Carrillo.

And beyond that, I think that even if there was jurisdiction in this case, I would probably still rule that there was not a sufficient allegations in this complaint to conclude that Dr. Carrillo is the purchaser, the individual purchaser or seller of these shares, other than the inference that they want to draw that it was in a Dr. Carrillo account. There's no evidence whatsoever that Dr. Carrillo had -- there's no allegation whatsoever that Dr. Carrillo had done any trading himself in this account; that he specifically was aware that any other activity was going on in Canada or in the United States with regard to any of these other defendants. There's not even an allegation of contact between Dr. Carrillo and any other defendant in this case with regard to being responsible for the purchase or sale that existed here. And I think it is

not sufficient to simply allege that Dr. Carrillo, a non-US resident, is the person whose name the stock is owned, so, therefore, that he is subject to personal jurisdiction in the United States in a civil lawsuit or enforcement action by the SEC; and that it makes him liable for the sale of unregistered securities, US securities, when those securities are sold by someone else who has power of attorney over his account.

So I think the allegations against Dr. Carillo are admittedly weak, and upon my review, insufficient to put Dr. Carrillo -- the charge to moot against Dr. Carrillo with regard to the claim alleged against him. Quite frankly, I'm not even sure even the allegation with regard to his being a relief defendant, it's unclear to me -- there's no allegation that would support that he's a relief defendant. There's no allegation he has any assets, any money that they say that is somehow proceeds of some illegal transaction. So I'm going to grant the motion by Dr. Carrillo.

There's a closer question with regard to Gibraltar. And I have been going back and forth, but I've decided that I should dismiss the claims against Gibraltar on this complaint. If the SEC wants to -- in light of our discussion wants to attempt to refashion a set of allegations -- and they don't have to refashion the whole complaint -- they want to propose by letter application additional or changed paragraphs with regard to the Gibraltar, and specify exactly what count and

under what theory under what count they're being charged, you know, they'll have leave to make that application. And Gibraltar can oppose that letter application so we don't have to go through a new round of motions.

But there are two -- and I have to simply say, I -- well, I hesitate to say confusing theories, but I have the first claim, the second claim and then I have the fifth claim, which is an aiding and abetting claim. Now, I really -- I can't see any facts in this case that I can point to that I can say that these are the facts that the SEC are relying upon to allege that Gibraltar knowingly provided substantial assistance to Ben Kirk's violations of Section 10(b). I understand their theory about red flags. When I understood it, I thought it got them closer than they were before, but, I mean, under that theory, their whole business is a red flag. So anybody who they've traded with, you could charge them with aiding and abetting. Anybody who might end up being charged with a securities violation or -- and I'm not quite sure why it's a red flag with regard to one securities violation as opposed to the other securities violation.

So I think that, as much as I'm trying to take the facts that are alleged against Gibraltar and fit that into a knowledgable participation in a violation of 10(b), those facts don't fit into that.

Particularly, I'm going to start with Count Five,

because Count Five is alone against Gibraltar and it's easier to articulate. But I don't see any facts in here that would say -- and this seems to be the theory, as I hear it -- would say that Gibraltar -- the way Gibraltar knowingly provided substantial assistance to Ben Kirk is that when they decided to do their business on behalf of Ben Kirk and basically trade the shares in their name, they were attempting and had the intent to help Ben Kirk violate Section 10(b). If that's the theory, then you have to tell me exactly why that's the theory and what facts would lead one to believe that they were knowingly providing substantial assistance to Ben Kirk's violation of 10(b).

Now, that seems to be a slightly different theory that's alleged under Count One and Count Two. And as we discuss it, it seems to me that only under B, with regard to the trades, the Scottsdale trades, that that's the only theory that you are asserting liability, in scheme liability. Again, Gibraltar, you know, if you're not alleging scheme liability and you're not alleging that they're liable for the scheme that the other people you say are involved in, then you need to articulate what scheme you say that he was involved in that's different and how his participation is legally different than his participation in knowingly or recklessly being involved in the scheme to defraud investors.

And the argument seems to be that you need not for B

allege that it was a scheme to defraud investors, as long as there were untrue statements. Well, then you have to tell me separately that they intended to make untrue statements; that they made it in connection with what transactions, and who else do you say is involved in that particular set of untrue statements that you say makes them codefendant on that count with them? It is not -- the second -- when I read the facts with regard to most of the other defendants in Counts One and Two, Carrillo, Carrillo Huettel, De Beer, Kirk, Hinton, the allegations with regard to those seem to be an independent set of allegations with an independent intent to defraud investors, primarily with a pump and dump scheme.

Now, if that's what you're trying to charge Gibraltar with, then make that clear that they're trying to allege the same thing, and give me the fact that puts them in that greater scheme. If you're just saying no, and they're just a separate -- they lied when they said who owns Scottsdale, if you want to say that they're liable for that just because they lied, then say that. If you want to say they lied because the evidence indicates they were attempting to facilitate the 10(b) violation, then say that, and tell me how that's been accomplished. But I don't think that it's sufficiently alleged the way it's alleged. And I think that it doesn't give Gibraltar sufficient notice as to what they're supposed to be defending themselves against. Either they're defending

themselves against the greater conspiracy that you lumped everybody else into or the greater activity or speed, or they're defending themselves within something different. And on what facts do you say that you will present that would make them independently liable on those claims?

I think that that -- I was struggling and thinking it was close, and maybe I would just let it go, since Gibraltar is here anyway, and it could flush itself out. But I really do think, given the discussion we had today, that it's unfair for Gibraltar to have to go forward and try to guess whether or not this is going to be a moving target and whether or not ultimately you're going to be arguing that they are a greater, more knowledgable participant in the scheme; or you're going to end up saying, well, we're really not going to try to prove that they were part of the greater scheme that they were accusing the others of, but we're just going to go against them on the single activity of just making misrepresentations about the nominee companies or the ownership of the stock when they made representations to Scottsdale on those trades.

If they have no greater participation, make that clear. If they do have greater participation and greater responsibility, then make that clear. But they're entitled to know what you claim, what you independently would prove against them about the extent of their activities and what those activities involve and what those activities were intended to

accomplish.

Now, with regard to the other defendants, I find that the allegations with regard to the other defendants, although in some respects with regard to each of the defendants, there are some vague and unspecified allegations. But I think the allegations on the whole against the firm, Carrillo Huettel and the lawyers, Ben Kirk, Hinton and De Beer, I think there are enough factual allegations with regard to -- and I'll just characterize it this way -- with regard to their relationships, their personal, individual and company relationships, their ownerships, their statements, their activities; I think the nature of the allegations with regard to each one of those is minimally sufficient, and some stronger than others. If I were to say, at this point I think the Hinton allegations are the most minimal. Some of the others have much more significant allegations as to their participations, their motive and opportunity, their statements, their participation in the companies and their ownerships of stock that as a whole, that I would say that if the SEC can prove that, in fact, they made the type of representations that they attribute to each one of them that they had the kind of ownership of the stock in relationship to the companies and each other, and they participated in the ways that they have alleged that they have participated in terms of things that were drafted concerning their companies, the activities or nonactivities of the

companies, representations about independence and concealment and/or -- and misrepresentation about their own personal ownership in the stocks that were being sold to unwary investors; if they can prove the specific allegations against each one of those defendants, a reasonable jury will -- be subject of dispute, and a reasonable jury could find, depending on the nature or the strength of the testimony and the evidence, they could find that they were liable for -- each one of those defendants were liable, depending on ultimately the strength of the evidence against them at trial.

Finally, I think, because I indicated with regard to venue, I think venue is appropriate. It takes minimal contact with this district. There is, I think, sufficient contact with this district to make this an appropriate venue. I think that an argument could be made that there may be obviously more contacts with two of the defendants in California rather than here, but that's not a compelling reason to send this case for the SEC or the other defendants, most of which it doesn't seem to be particularly any more convenient for them to get to San Diego than to come to New York, quite frankly; probably less convenient to go to San Diego than to go to New York from Canada and some other places. But regardless of that, I don't think that it's so compelling that it should overcome the government's choice of forum at this point. And it's chosen New York as the forum to bring this action, and it is the venue

that is available and appropriate for them to bring this action.

With regard to I guess the other issues, with regard to the service of process, I find that service of process was reasonable and appropriate. And the representations that were made in order to get substituted process was appropriate and reasonable. I find that they made a reasonable attempt. As I said, the question is not whether or not they did everything they could have done to find him. The question is whether or not, given his last known address and no one willing to provide a current address or accept service on his behalf -- it hasn't been explained to me exactly what would have possibly been a more fruitful attempt to serve him that should have been attempted prior to attempting to try to serve him several times at his last known address, trying to find a new address for him through his lawyers and/or trying to seek that his lawyers accept service of process on his behalf. I think those are reasonable steps. Those steps were communicated to the Court.

There are other reasonable steps. In most cases there's always something else you could have done. But I don't think the law requires that they come up with some other step, which, quite frankly, has not been articulated to me today what step would have been likely to be fruitful to have located the defendant for service.

So even at this point in hindsight, it's not

articulated to me that they had an opportunity to do something that would have clearly revealed the whereabouts of the defendant and given him an opportunity to serve them, and they obviously should have done that and they did not do that. It hasn't been articulated in that way because I don't think there's anything that could be argued that there's some specific thing that if they had done it, that they would have miraculously located the defendant, who was obviously not doing anything to make himself available for service, even though it would be obvious to his lawyers, and one would assume to him, that service by the SEC was attempted and was desired. So I don't see that as a basis for filing the service of process is inappropriate.

So I think it's time to move forward with this case. As I say, if the SEC wants to try to see if you can reformulate, you know, a count or two with regard to Gibraltar, I'll consider that. Look at the new set of allegations. Let them respond. And if it's appropriate, I will let you move forward with that. I'm not going to preclude you from attempting to do that further with Dr. Carrillo, if you think that the attempt, given my issues and concerns, that an effort can be made, successful effort, to sufficiently allege stronger and sufficient facts against Dr. Carrillo.

But my assessment at this point is that I can't imagine in what way you would be able to overcome both the

jurisdictional issue and the pleading issue with regard to his liability. I think that it seems to me that that attempt would be futile. But if you would like to attempt to do that, then I'll look at that very quickly and determine whether or not I think that that would not be futile. But I can't anticipate what you could do to overcome the jurisdictional issue. There's not a set of facts that you need to allege or a new complaint that you need to allege. I think we know what the facts are with regard to that, and I don't think that those issues could be overcome.

So if you intend to attempt to amend with regard to any defendant, or particularly with regard to Gibraltar and/or Dr. Carrillo, that should be done in the next 30 days.

Also, in that period of time I need the parties to get together, sit down and hash out a schedule. To the extent that you agree, give me a joint letter. To the extent that you don't agree in that joint letter, give me the portions where you don't agree and then I'll either resolve it, or if it takes some more complicated discussion, I'll bring you in before me or assign you to a magistrate judge. And the magistrate judge can monitor discovery so you can go forward.

So you should come up with a new schedule. I don't want this case to be any further delayed. But in further reviewing this case, I think I'm sufficiently comfortable with my ruling today so that the parties can immediately,

efficiently start to move forward with the case.

Yes.

MR. BRODY: Yes, your Honor. Just one brief clarification question, which is I understand that you have granted the motion of Gibraltar with respect to the first claim, the second claim and the aiding and abetting claim, which is the fifth claim.

With respect to the Section 5 claims, 11 and 12, have you dismissed those? We've alleged those as well, your Honor.

THE COURT: As a matter of fact, I'm glad you reminded me of that.

I am not dismissing the Section 5. The Section 5 claim was sufficiently alleged with regard to Gibraltar. So Gibraltar is still in this case on that count. If you want to put them into a securities fraud scheme, then give me that. If you want to put them into a misrepresentation count with regard to a specific limited set of misrepresentations that they alone made or that they made in conjunction with others, then specify that. But I think you need to do that.

But with regard to the 5 claim, I think that, given the nature of the purchase and sale of the securities, I think you sufficiently alleged those.

MR. BRODY: And that's with respect to Davis as well, who's a defendant in both of those, in both of those, claim 11 and 12.

THE COURT: Yes. Yes. That's why I didn't address Davis.

I'm not granting Davis' motion. I think that he's not charged with regard to the -- that's why we had that discussion. I was asking you, he was not charged in Counts One and Two through Five, and I think he has a sole count against him of liability.

So I'm going to deny the motion to dismiss him out of the case. I think clearly the allegations in the complaint are sufficient to make allegations about his participation with Gibraltar and the actions with regard to the sale of the shares.

MR. O'ROURKE: Your Honor, Kevin O'Rourke. Just briefly, Mr. Davis was also moved in the other case, the smaller case. I take it you're not granting his motion?

THE COURT: Yes. I apologize. Yes. My ruling with regard to Gibraltar in the other case was with regard to both Gibraltar and Davis and the other counts. So that's the ruling.

So what I'm going to do is at this point I'm just going to schedule -- I'll schedule a conference. We'll see if we need it or need one earlier or later. I'm going to schedule a conference for like late June, maybe like June 25th. Wednesday, June 25th at 10:00. Get a schedule together. Start answering. If you're going to attempt to amend, do that. Get

that out of the way. And then if you don't need that conference, if you just move forward with discovery, send me a letter and we'll put it off until later in the summer or the fall.

But otherwise, if we have issues to resolve, let me know what they are by letter so I can be prepared for them and we can resolve them at that conference.

Yes.

MR. GOUREVITCH: Your Honor, I would ask if we could schedule a conference for anytime in early July, if it would be convenient. I may have a scheduling conflict for June 25th.

THE COURT: I don't have a problem with that. Is July 8th --

MR. GOUREVITCH: Yes, your Honor. Thank you very much.

THE COURT: Tuesday, July 8th, 10:00? I'll schedule it for that time. We'll see if we really need it at all.

So let me know to the extent that you can agree on how to proceed. If you can't, let me know right away so I can resolve those issues. And I'd like to discuss that within the next 30 days, too, about exactly how you're going to proceed. Okay?

Thank you all very much.

(Adjourned)